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# INFORMATION ABOUT THE STATE REAL ESTATE BROKER EXAM

PSI provides a candidate's handbook that contains your exam application. It is available at [realestateschoolchicago.com/candidate](http://realestateschoolchicago.com/candidate) and provides you with specific information regarding your state exam. Please read it carefully. This guide was written to be a streamlined review of the material presented in the classroom. More in-depth information about each subject is contained in the textbook.

## **Allocations of State Real Estate Broker Exam Questions by Chapter**

The following table provides the number of questions in the State Real Estate Broker Exam allotted to various chapters in this book. There are two sections on the Illinois State Exam for Real Estate Brokers.

<b>National Section of the Test</b>	<b>Percentage of Questions</b>	<b>Chapter(s) in the Book</b>
Property Ownership	8%	1, 2
Land Use Controls and Regulations	5%	3
Valuation and Market Analysis	7%	4, 7
Financing	10%	6
General Principles of Agency	13%	11, 13, 14
Property Disclosures	6%	8, 11
Contracts	17%	12, 5
Leasing and Property Management	3%	15
Transfer of Title	8%	9, 10
Practice of Real Estate Calculations	10%	17, Appx. A

<b>State Section of the Test</b>	<b>Number of Questions</b>	<b>Chapter(s) in the Book</b>
Licensing Requirements	10	16
Laws and Rules Regulating Real Estate Practice	20	16
Disclosures	10	8, 16

## 2020 NATIONAL REAL ESTATE BROKER EXAMINATION DETAILED CONTENT OUTLINE

### **I. Property Ownership (8%)**

#### **A. Real versus personal property; conveyances**

#### **B. Land characteristics and legal descriptions**

1. Types of legal descriptions; Metes and bounds, Lot and block, government survey
2. Measuring structures
3. Livable, rentable, and usable area
4. Land Measurement
5. Mineral, air, and water rights

#### **C. Encumbrances and effects on property ownership**

1. Liens
2. Easements and licenses
3. Encroachments
4. Other potential encumbrances of title

#### **D. Types of ownership**

1. Tenants in common
2. Joint tenancy
3. Common-interest ownership
  - a) Timeshares
  - b) Condominiums
  - c) Co-ops
4. Ownership in severalty/sole ownership
5. Life Estate ownership

### **II. Land use controls and regulations (5%)**

#### **A. Government rights in land**

1. Property taxes and special assessments
2. Eminent domain, condemnation, escheat

#### **B. Government controls**

1. Zoning and master plans
2. Building codes
3. Regulation of special land types
  - a) Flood zones
  - b) Wetlands
4. Regulation of environmental hazards
  - a) Types of hazards
  - b) Abatement and mitigation
  - c) Restrictions on contaminated property

#### **C. Private controls**

1. Deed conditions or restrictions
2. Covenants, conditions, and restrictions (CC&Rs)
3. Homeowners' association regulations

### **III. Valuation and market analysis (7%)**

#### **A. Appraisals**

1. Purpose and use of appraisals for valuation
  2. General steps in appraisal process
  3. Situations requiring appraisal by certified appraiser
  - B. **Estimating Value**
    1. Effect of economic principles and property characteristics
    2. Sales or market comparison approach
    3. Cost approach
    4. Income analysis approach
  - C. **Competitive/Comparative Market Analysis**
    1. Selecting comparables
    2. Adjusting comparables
- IV. **Financing (10%)**
- A. **Basic concepts and terminology**
    1. Points
    2. LTV
    3. PMI
    4. Interest
    5. PITI
    6. Financing instruments (mortgage, promissory note, etc).
  - B. **Types of loans**
    1. Conventional loans
    2. FHA Insured loans
    3. VA guaranteed loans
    4. USDA/rural loan programs
    5. Amortized loans
    6. Adjustable-rate mortgage loans
    7. Bridge loans
    8. Owner financing (installment and land contract/contract for deed)
  - C. **Financing and lending**
    1. Lending process application through closing
    2. Financing and credit laws and rules
      - a) Truth in lending
      - b) RESPA
      - c) Equal Credit Opportunity
      - d) CFPB/TRID rules on financing and risky loan features
    3. Underwriting
      - a) Debt ratios
      - b) Credit scoring
      - c) Credit history
- V. **General principles of agency (13%)**
- A. **Agency and non-agency relationships**
    1. Types of agents and agencies
    2. Other brokerage relationship (non-agents)
      - a) Transactional
      - b) Facilitators

- B. **Agent's duties to clients**
  - 1. Fiduciary responsibilities
  - 2. Traditional agency duties (COALD)
  - 3. Powers of attorney and other delegation of authority
- C. **Creation of agency and non-agency agreements; disclosure of conflict of interest**
  - 1. Agency and non-agency agreements
    - a) Key elements of different types of listing contracts
    - b) Key elements of buyer brokerage/tenant representation contracts
  - 2. Disclosure when acting as principal or other conflict of interest
- D. **Responsibilities of agent to customers and third parties, including disclosure, honesty, integrity, accounting for money**
- E. **Termination of agency**
  - 1. **Expiration**
  - 2. Completion/performance
  - 3. Termination by force of law
  - 4. Destruction of property/death of principal
  - 5. Mutual agreement

**VI. Property disclosures (6%)**

- A. **Property condition**
  - 1. Property condition that may warrant inspections and surveys
  - 2. Proposed uses or changes in uses that should trigger inquiry about public or private land use controls
- B. **Environmental issues requiring disclosure**
- C. **Government disclosure requirements (LEAD)**
- D. **Material facts and defect disclosure**

**VII. Contracts (17%)**

- A. **General knowledge of contract law**
  - 1. Requirements for validity
  - 2. Factors affecting enforceability of contracts
  - 3. Void, voidable, unenforceable contracts
  - 4. Rights and obligations of parties to a contract
  - 5. Executory and executed contracts
  - 6. Notice, delivery, and acceptance of contracts
  - 7. Breach of contract and remedies for breach
  - 8. Termination, rescission, and cancellation of contracts
  - 9. Electronic signature and paperless transactions
  - 10. Bilateral vs unilateral contracts (option agreements)
- B. **Contract Clauses, including amendments and addenda**
- C. **Offers/purchase agreements**
  - 1. General requirements
  - 2. When offer becomes binding
  - 3. Contingencies
  - 4. Time is of the essence
- D. **Counteroffers/multiple offers**

1. Counteroffers
2. Multiple offers

**VIII. Leasing and Property Management (3%)**

- A. **Basic concepts/duties of property management**
- B. **Lease Agreements**
  1. Types of leases, e.g., percentage, gross, net, ground
  2. Key elements and provisions of lease agreements
- C. **Landlord and tenant rights and obligations**
- D. **Property manager's fiduciary responsibilities**
- E. **ADA and Fair Housing compliance in property management**

**IX. Transfer of Title (8%)**

- A. **Title Insurance**
  1. What is insured against
  2. Title searches, title abstracts, chain of title
  3. Marketable vs insurable title
  4. Potential title problems and resolution
- B. **Deeds**
  1. Purpose of deed when title passes
  2. Types of deeds and when used
  3. Essential elements of deeds
  4. Importance of recording
- C. **Escrow or closing; tax aspects of transferring title to real property**
  1. Responsibilities of escrow agent
  2. Prorated items
  3. Closing statements/TRID disclosures
  4. Estimating closing costs
  5. Property and income taxes
- D. **Special processes**
  1. Foreclosure
  2. Short sale
- E. **Warranties**
  1. Purpose of home or construction warranty programs
  2. Scope of home or construction warranty programs

**X. Practice of real estate (13%)**

- A. **Trust/escrow accounts**
  1. Purpose and definition of trust accounts, including monies held in trust accounts
  2. Responsibility for trust monies, including commingling/conversion
- B. **Federal fair housing laws and the ADA**
  1. Protected classes
  2. Prohibited conduct (red-lining, blockbusting, steering)
  3. Americans with Disabilities Act (ADA)
  4. Exemptions
- C. **Advertising and technology**
  1. Advertising practices

- a) Truth in advertising
- b) Fair housing issues in advertising
- 2. Use of technology
  - a) Requirements for confidential information
  - b) Do-Not-Call List

D. **Licensee and responsibilities**

- 1. Employee
- 2. Independent Contractor
- 3. Due diligence for real estate transactions

E. **Antitrust laws**

- 1. Antitrust laws and purpose
- 2. Antitrust violations in real estate

**XI. Real estate calculations (10%)**

A. **Basic math concepts**

- 1. Loan-to-value ratios
- 2. Discount points
- 3. Equity
- 4. Down payment/amount to be financed

B. **Calculations for transactions**

- 1. Property tax calculations
- 2. Prorations
- 3. Commission and commission splits
- 4. Seller's proceeds of sale
- 5. Buyer funds needed at closing
- 6. Transfer fee/conveyance tax/revenue stamps
- 7. PITI (Principal, Interest, Taxes, and Insurance) payments

## 2020 ILLINOIS STATE EXAMINATION OUTLINE

The content outline for the state portions of the examinations has been approved by the Illinois Department of Financial and Professional Regulation. This portion tests knowledge areas that are required specifically for the Illinois real estate professional.

1. **License Requirements**
  - A. License exemptions
  - B. Activities requiring a license
  - C. Types of licenses
    1. Broker
    2. Managing Broker
    3. Leasing Agent
  - D. Assistants
  - E. Eligibility for licensing
  - F. Examination
  - G. License renewal
  - H. Continuing education
  - I. Change in licensee information
  - J. Reciprocity
  - K. Real Estate Recovery Fund
2. **Laws and Rules Regulating Real Estate Practice**
  - A. Purpose of license law
  - B. Advertising (other than disclosure)
  - C. Broker/broker relationship
  - D. Commissions
    1. Finder's fee/referral fee
    2. Rental finding services
  - E. Ownership issues
    1. Land trust
    2. Homestead
  - F. Handling of monies
    1. Special accounts
    2. Security deposits
  - G. Handling of documents
  - H. Performing activities exceeding scope of real estate licensing
    1. Law
    2. Securities
  - I. Transfer tax stamps/affordable housing
  - J. Intestacy
  - K. Legal description/Plat Act
  - L. Real estate taxes and exemptions
  - M. Illinois Human Rights Act
  - N. Interference with contracts or listings
3. **Disclosures**
  - A. Agency



1. Designated agencies
  - a. Seller
  - b. Buyer
  - c. Dual
- B. Advertising
- C. Property disclosures
  1. Residential Real Property Disclosure Act
  2. AIDS (HIV)
  3. Stigmatized property
  4. Material defects

## NUMBER OF QUESTIONS FOR THE STATE BROKER PORTION

Licensing Requirements	10
Laws and Rules Regulating Real Estate Practice	20
Disclosures	10

### Types Of Questions In The State Broker Exam

In addition, all items will be classified according to the cognitive level that is expected to be required for the entry-level candidate to appropriately respond to the item. The cognitive level classifications are defined in the following table, which also shows the percentage of items at each level for the broker examination.

Level	Definition	Percentage of Questions
Recall/Recognition	To identify, recall or recognize terms, facts, methods, procedures, basic concepts, principles, and processes	41
Application/Analysis	To apply concepts and principles to situations to identify solutions; calculate solutions to mathematical problems; interpret charts and graphic data; classify items; and interpret information	59

Each question may contain up to EIGHT options and ONLY ONE BEST option shall be selected to answer the question.

Some options are appropriate but NOT the BEST ANSWER.

Select the option that best answers the question in the exam.

A **BEST ANSWER** reflects the optimal solution or most complete resolution to the scenario presented in the question.

## EFFECTIVE LEARNING METHODS UTILIZING THIS BOOK AND ONLINE RESOURCES

### **Bold Type — Take Notes**

Key information is highlighted in bold type. As a key learning tool, write these items down in your personal learning notebook.

### **Underlined Bold Type — Highlight Notes**

Underlined and bold items are likely to be subjects of questions in the State Exam. Highlight these items in your personal learning notebook. Spend time at each chapter, making sure that you understand these concepts.

### **Bold and Underlined Bold Information — Say Aloud**

It is a fact that in addition to seeing the information on your screen, writing down notes, and hearing the material (your own voice is fine) enhances learning and memory.

### **Summary**

The more senses you involve in learning, the better you will learn the material, and you will retain it longer.

Utilizing three senses — visual, aural, and touch — will guarantee that you are maximizing your learning experience. Faithfully following these learning techniques will enable you to pass the Illinois Real Estate Broker Exam.

### **Learning Procedure**

1. Read the chapter quickly to see what is being covered.
2. Read over the chapter slowly, taking notes and speaking key sentences and phrases out loud, so you can hear them.
3. Lookup any words you don't understand in the glossary at the back of the book.
4. Re-read the sections of the chapter that pertains to any concept or State Study Point that you cannot remember or that you don't quite understand.
5. Take the chapter quiz at the end of each chapter.
6. Mark the questions down on your notes that you got wrong. (You will be studying this material again at the end of the course and taking the sample test to make sure that you get them right at that time).
7. Proceed to the next chapter.

### **Other Study Tips**

- Ask friends and family to allow you some space and privacy to study this material. It will take a commitment from you and them to find time and privacy to study.
- Make a commitment and stick with it. Too many distractions will take you away from the work you need to put in to obtain your goal - a Real Estate Broker's License. In fact, make out a little sign with your goal of completing this course and obtaining your license and mount it within

eyesight where you study or someplace where you can see it each day. The sign should read "Real Estate Broker's License by July 20" or whatever date that might be your goal.

Although some teens can study with the TV blasting or listening to loud music, for most people, especially those out of their teens, learning and retention require a quiet space to concentrate on the material to be mastered. You may need to study in a library, the basement, the attic, a coffee shop that is not noisy, or some other quiet and subdued place out of your home.

### **Testing Knowledge Through Questions**

Taking in the information, understanding it, and remembering it is only part of what you have to do to prepare for the State Real Estate Exam. You also have to have some experience of how the state will test this knowledge. They will test your knowledge through QUESTIONS.

The material you learn will be re-worked by a test developer, to come at the knowledge from several different angles. Some students will be able to anticipate these twists and turns, and others cannot.

**The best way to gain a skill of anticipating how the basic material you learn will be presented in a different manner of questions is to practice answering questions about the material you have learned. The more questions you try to answer, the better you will be able to answer them in the state exam.**

**SO, ANSWER THE QUESTIONS ONLINE AFTER YOU HAVE STUDIED THE CHAPTER.**

**Also, it is recommended that you purchase the sample test from AMP, which is available at [www.realestateschoolchicago.com/amp-test](http://www.realestateschoolchicago.com/amp-test), to get a better feel of the way the questions are stated in the state exam.**

## **GENERAL STRUCTURE OF THE QUESTIONS**

### **Multiple Choice Questions**

The questions on the exam for the Illinois Real Estate Broker License are multiple-choice. This is an advantage for the person taking the exam because the answer is provided for each question. As a result, reasonably intense study will provide enough familiarity with this material to answer a large number of questions without having to commit all the material to memory. The answer will be available in the list of possible answers.

### **Memory**

Tests knowledge of definitions, the meaning of words and phrases used in Real Estate. This material has to be memorized. Shortlists are prime targets for this type of question, so they should be memorized. Definitions of concepts that can result in a single word or phrase answer are also prime targets. These questions should be answered in the first read-through of the state exam.

### **Analysis**

These are more complicated questions. They involve relating several concepts to come up with an answer. They should be done only in the second or third read-through of the state exam. They should

be read slowly and carefully when answering the questions at the end of each chapter of this book and while taking the state exam.

### **Application**

They will take a word or phrase and ask where it is used, or how it is used in real estate transactions. They may also ask where the concept is carried out in real-life.

### **Common Traps**

Many students read the questions too quickly and do not notice some keywords which change the meaning of the question radically. Here are a few examples:

- **Except**
- **Not**
- **Several answers seem alike, but only a word or two differentiate them.**
- **Best Answer** — several answers seem to be applicable, but one is the best
- **Which is True?**
- **Which is False?**
- **"Which of the following is *TRUE*?"** means there are three wrong answers and one true answer.
- **What is the difference?**
- **What do they have in common?**
- **Most Likely**

In all of these situations, it takes a **careful and slow reading** of the question to spot the traps or items that have to be taken into consideration, which are not apparent in a quick reading of the question. These questions should never be answered in the first sweep through the exam.

**The state broker exam is designed for the average person to pass.**

The state spends considerable time developing questions that are not too hard or too simple. Some questions do not count toward your score but are being evaluated for use in future exams. Since there is no way to know which questions are not counted, it's important to answer every question on the exam.

Notes:

[illegible]

# CHAPTER 1: INTRODUCTION TO REAL ESTATE AND REAL PROPERTY

## THE REAL ESTATE BUSINESS

There are many specialties in the Real Estate Business, among them are included:

### **Brokerage**

*Brokerage* is the business of bringing people together in a real estate transaction. A real estate licensee acts as a point of contact between two or more people in negotiating the sale, purchase, or rental of property.

### **Appraisal**

*Appraisal* is the process of estimating a property's market value based on established methods and the appraiser's professional judgment. Although real estate training will give brokers and sponsoring brokers some understanding of the valuation process, most lenders require that a professional appraisal by a licensed appraiser accompany a loan package.

### **Property management**

A *property manager* is a person or company hired to maintain and manage property on behalf of its owner. By hiring a property manager, the owner is relieved of many day-to-day management tasks, such as finding new tenants, collecting rents, altering, or constructing new space for tenants, ordering repairs, and generally maintaining the property.

### **Financing**

*Financing* is the business of providing the funds that make real estate transactions possible. Most transactions are financed by means of mortgage loans or trust deed loans secured by the property. Individuals involved in financing real estate may work in commercial banks, mortgage banking, or mortgage brokerage companies.

### **Subdivision and development**

*Subdivision* is the splitting of a single property into smaller parcels. *Development* involves the construction of improvements on the land. These improvements may be either on-site or off-site.

### **Home Inspection**

Licensed and certified home inspectors conduct a thorough visual survey of a property's structure, systems, and site conditions and prepare an analytical report that is valuable to both purchasers and homeowners.

### **Counseling**

*Counseling* involves providing clients with competent, independent advice based on sound professional judgment. A real estate counselor helps clients choose among the various alternatives involved in purchasing, using, or investing in property.

## Education

*Real estate education* is available to both practitioners and consumers. Colleges and universities, private schools, and trade organizations **all** conduct real estate courses and seminars, from the principles of a pre-licensing program to the technical aspects of tax and exchange law.

## Auctioning

Buying or selling real estate at auction uses an open and competitive bidding process to transfer property.

## PROFESSIONAL ORGANIZATIONS

**National Association of REALTORS® (NAR)** is the largest real estate organization. Its Website is [www.realtor.org](http://www.realtor.org). The NAR sponsors various affiliated organizations that offer professional designations to brokers, managing brokers, and other professionals who complete required courses in areas of special interest. Members subscribe to a Code of Ethics and are entitled to be known as REALTORS® or REALTOR-ASSOCIATES. **You must be a member of NAR to use the term REALTOR®.**

**The National Association of Real Estate Brokers (NAREB)**, whose members are known as *Realtists*, also adheres to a code of ethics. The NAREB arose out of the early days of the civil rights movement as an association of racial minority real estate brokers in response to the conditions and abuses that eventually gave rise to fair housing laws. Today, the NAREB remains dedicated to equal housing opportunity.

**The National Association of Hispanic Real Estate Professionals (NAHREP)** is the largest minority trade group in the real estate industry. Its mission is to increase the rate of sustainable Hispanic homeownership by empowering real estate professionals that serve the Hispanic community.

**The Asian Real Estate Association of America (AREAA)** is a non-profit professional trade organization dedicated to promoting sustainable homeownership opportunities in Asian American communities.

## Types Of Real Property

Just as there are areas of specialization within the real estate industry, there are different types of property in which to specialize. Real estate can be classified as:

- **RESIDENTIAL** - single-family or multifamily housing, in urban, suburban, or rural areas,
- **COMMERCIAL** - office space, shopping centers, stores, theaters, hotels, and parking facilities,
- **INDUSTRIAL**- warehouses, factories, land in industrial districts, and power plants,
- **AGRICULTURAL** - farms, timberland, ranches, and orchards,
- **SPECIAL PURPOSE** - churches, schools, cemeteries, and government-held lands.

## THE REAL ESTATE MARKET

### Supply and Demand

The forces of supply and demand in the market determine how prices for goods and services are set. Greater supply means producers need to attract more buyers, so they lower prices. Greater demand means producers can raise their prices because buyers compete for the product.

### Supply and demand in the real estate market

Two characteristics of real estate govern the way the market reacts to the pressures of supply and demand: **uniqueness and immobility**.

**Uniqueness** means that no matter how similar two parcels of real estate may appear, they are never *exactly* alike. Each occupies its own unique geographic location, and two properties are never exactly the same inside.

**Immobility** refers to the fact that property cannot be relocated to satisfy demand where supply is low. Nor do buyers necessarily make relocation decisions based on greater housing supply in a certain locale. For these reasons, real estate markets are *local markets*.

**When supply increases and demand remains stable, prices go down.**

**When demand increases and supply remains stable, prices go up.**

## FACTORS AFFECTING SUPPLY

### Labor force and construction costs

A shortage of skilled labor or building materials or an increase in the cost of materials can decrease the amount of new construction.

### Government Controls

Local governments also can influence supply. Land-use controls, building codes, and zoning ordinances help shape the character of a community and control the use of land.

### Governmental Financial Policies

The government's **monetary policy** can have a substantial impact on the real estate market. The Federal Reserve Board establishes a discount rate of interest for the money it lends to its member banks. These interest rates play a significant part in people's ability to buy homes.

Governmental **agencies**, such as the **Federal Housing Administration (FHA)** and the **Department of Veterans Affairs (VA)**, also have an impact by insuring or guaranteeing loans.

Policies on the **taxation** of real estate can have both significant and complex effects on the real estate market. Real estate taxation is a necessary source of revenue for local governments.



## FACTORS AFFECTING DEMAND

**Population** Shelter is a basic human need, so the demand for housing grows with the population. Although the total population of the country continues to rise, the demand for real estate increases at a faster rate in some areas than in others.

**Demographics** is the study and description of the population. The population of a community is a major factor in determining the quantity and type of housing in that community. Family size, the ratio of adults to children, the ages of children, the number of retirees, family income, lifestyle, and the growing number of single-parent and empty nester households are all demographic factors that contribute to the amount and type of housing needed.

**Employment and wage levels** Decisions about whether to buy or rent and how much to spend on housing are closely related to income. When job opportunities are scarce or wage levels low, demand for real estate usually drops.

## LAND, REAL ESTATE, AND REAL PROPERTY

**Land** is defined as **the earth's surface extending downward to the center of the earth and upward to infinity.**

Land includes not only the surface of the earth but also the underlying soil. Land also refers to objects that are naturally attached to the earth's surface, such as boulders and plants. Land includes the minerals and substances that lie far below the earth's surface (*subsurface*). It even includes the air above the earth, all the way up into space (*airspace*).

**Real Estate** is defined as **land at, above, and below the earth's surface, plus all things permanently attached to it.**

The term real estate is similar to the term land, but it means much more. **Real estate includes natural land, along with all human-made improvements.** An improvement is any artificial addition to land, such as a building or a fence. The term **improvement**, as used in the real estate industry, refers to any addition to the land. Land also may be improved by streets, utilities, sewers, and other additions that make it suitable for building.

**Real Property** is defined as the interests, benefits, and rights that are included in the ownership of land and real estate.

Real property includes the surface, subsurface, airspace, any improvements, and The **Bundle Of Legal Rights**—the legal rights of ownership that attach to the ownership of a parcel of real estate.

## Air Rights

The rights to use the space above the earth may be sold or leased independently, provided the rights have not been preempted by law. Air rights can be an important part of real estate, particularly in large cities where air rights over railroads must be purchased to construct office buildings. Now that air travel is common, the courts and the U.S. Congress have put limits on air rights.

With the continuing development of solar power, air rights, solar rights, and even "view" rights are being closely examined by the courts. Air and solar rights are established by laws and ordinances that vary widely from state to state.

## OWNERSHIP OF REAL PROPERTY

Traditionally, ownership of real property is described as a BUNDLE OF LEGAL RIGHTS. In other words, a purchaser of real estate actually buys the rights of ownership held by the seller. These rights include the rights of:

1. Possession
2. Control
3. Enjoyment
4. Exclusion
5. Disposition

The concept of a bundle of rights comes from old English law. In the Middle Ages, a seller transferred property by giving the purchaser a handful of earth **or** a bundle of bound sticks from a tree on the property, symbolizing the whole property. The purchaser, who accepted the bundle in a ceremony, became the owner of the tree producing the sticks *and* the land to which the tree was attached. Because the rights of ownership (like the sticks) can be separated and individually transferred, the sticks became symbolic of those rights.

## PERSONAL PROPERTY

**Personal property is movable.** Items of personal property, also referred to as chattels, include such tangibles as chairs, tables, clothing, money, bonds, and bank accounts.

### Manufactured Housing vs Mobile Homes

**Manufactured housing** – now normally permanently attached to a concrete pad or foundation and is **taxed as real estate**.

**Mobile homes** – Designed to be moved. Not permanently attached to the land (set on blocks, jacks, or wheels) and are **taxed as personal property**.

### Plants

Trees and crops generally fall into one of two classes:

1. **Fructus Naturales - Real Estate** - Trees, perennial shrubbery, and grasses that do not require annual cultivation are considered real estate. They attach to the land.
2. **Fructus Industriales - Emblements or Personal Property - Annually cultivated crops** such as wheat, corn, vegetables, and fruit, are generally considered personal property. As long as an annual crop is growing, it will stay with the real property unless other provisions are made in the sales contract.

**Conversion** is the general name for converting real property into personal property or personal property into real property.

**Severance** is the operation whereby real property is converted to personal property:

Cutting down a tree (real property) and converting it into boards (personal property); tearing down a barn (real property) and converting it into a stack of boards (personal property).

**Annexation** is the operation whereby personal property is converted into real property. For example, a landowner buys cement, stones, and sand, mixes them into concrete, and constructs a sidewalk across her land. This landowner has effectively converted personal property (cement, stones, and sand) into a real property (a sidewalk).

## FIXTURES

**A fixture** is a personal property that has been so affixed to land or a building that, by law, it becomes part of the real property. Examples of fixtures are heating systems, elevator equipment in high-rise buildings, radiators, kitchen cabinets, attached bookcases, light fixtures, and plumbing fixtures. Almost any item that has been added as a permanent part of a building is considered a fixture. During the course of time, the same materials may be both real and personal property, depending on their use and location.

### Legal tests of a fixture

The overall test that is used in determining whether an item is a fixture or personal property is a question of intent, in most cases:

1. **Method of attachment** - How permanent is the method of attachment? Can the item be removed without causing damage to the surrounding property?
2. **Adaptation to real estate** - Is the item being used as real property or personal property?
3. **Agreement between the Parties - THE MOST IMPORTANT METHOD OF DETERMINING A FIXTURE** - Usually spelled out in the Sales Contract concerning what goes and what stays. Have the parties agreed in writing on whether the item is real or personal property? What does the contract say?

At the time a property is listed, the seller and real estate agent should discuss which items will be included in the sale. **Any item that the seller does not want to be included in the sale should be replaced prior to public viewing.**

**The written sales contract between the Buyer and the Seller (agreement between the parties), should list articles which the Buyer and Seller agree can be moved and articles which the Buyer and Seller agree are to remain with the property, to eliminate any doubt as to whether they are personal property or fixtures.**

### Trade fixtures

A Trade Fixture is defined as **Personal Property of a business owner**, that, **when attached** to a rented space or building, **remains personal property**. Some examples of trade fixtures are bowling alleys, store shelves, bars, and restaurant equipment. Some additional considerations relating to Trade Fixtures are:

1. Trade fixtures must be removed on or before the last day the property is rented.
2. The tenant is responsible for any damage caused by the removal of a trade fixture.
3. Trade fixtures that are not removed become the real property of the landlord.

## CHARACTERISTICS OF REAL ESTATE

### Economic Characteristics

#### Scarcity

We usually do not consider land a rare commodity, but only a quarter of the earth's surface is dry land; the rest is water. The total available supply of land is not limitless. While a considerable amount of land remains unused or uninhabited, the supply in a given location is generally considered to be limited.

#### Improvements

Building an improvement on one parcel of land can affect the land's value and use as well as that of neighboring tracts and whole communities. For example, constructing a new shopping center or selecting a nuclear power site or toxic waste dump can dramatically shift land values in a large area.

#### Permanence of investment

The capital and labor used to build an improvement represent a large, fixed investment. Although even a well-built structure can be razed to make way for a newer building, improvements such as drainage, electricity, water, and sewage systems often remain. The return on such investments tends to be long term and relatively stable.

#### Location

This economic characteristic, sometimes called **area preference** or **situs**, does not directly refer to a geographic location but rather to **people's preferences for given areas**. It is the unique quality of these preferences that result in different values for similar units.

**Preferential location is the most important economic characteristic of land.**

### Physical Characteristics

#### Immobility

The ***geographic location of any given parcel of land can never be changed***. It is fixed or ***immobile***. Some of the substances of land are removable, and that topography may shift.

#### Indestructibility

**Land also is indestructible. Because Land is indestructible, Land does not depreciate.** Man-made ***improvements on land depreciate*** and can become obsolete, which may dramatically reduce the land's value. This gradual depreciation should not be confused with the knowledge that the economic desirability, therefore the value of a given location, can change.

#### Uniqueness

**No two parcels of land are ever exactly the same.** Although they may be very similar, all parcels differ geographically because each parcel has its own location. An individual parcel has no substitute because each is unique. The uniqueness of land also is referred to as *nonhomogeneity*.

## LAWS AFFECTING REAL ESTATE

### Seven Sources of Law

1. United States Constitution
2. Laws passed by Congress
3. Rules of the regulatory agencies
4. State constitutions
5. State statutes
6. Local ordinances
7. Common law

The unique nature of real estate has given rise to an equally unique set of laws and rights. Even the simplest real estate transaction involves a body of complex laws. Licensees must have a clear and accurate understanding of the laws that affect real estate.

The specific areas important to the real estate practitioner include:

1. Law of contracts,
2. General property law,
3. Law of agency,
4. The state's real estate license law,
5. Environmental laws,
6. Federal, state, and local tax laws,
7. State and local land-use and zoning laws,
8. Environmental regulations.

## ILLINOIS REAL ESTATE LAW

### Specific Real Estate Laws

The practice of real estate in Illinois is governed by the Real Estate License Act of 2000 (amended in 2010 and 2019) and Rules established by the Illinois Department of Financial and Professional Regulation. Other laws affecting real estate in Illinois may be found throughout the Illinois compiled statutes, but many of those addressing real property are in **Chapter 765, ILCS**

**The purpose of real estate license law is to protect the public from fraud, dishonesty, and incompetence in real estate transactions.**

## HOME OWNERSHIP

### Ownership Expenses and Ability to Pay

Homeownership involves many expenses, including utilities (such as electricity, natural gas, and water), trash removal, sewer charges, and maintenance and repairs. Owners also must pay real estate taxes and buy private mortgage insurance, and they must repay the mortgage loan with interest. This is what lenders refer to as PITI (principal, interest, taxes, and private mortgage insurance) - those expenses that comprise a monthly payment.

## **Mortgage Terms**

To determine whether a prospective buyer can afford a certain purchase, most lenders use automated underwriting and credit scoring. Certain costs associated with the home purchase (principal and interest payment, taxes, and private mortgage insurance — PITI) as well as total debt could not exceed a certain percentage of monthly, pre-tax (gross) income. But today, credit scores play a key role when lending institutions decide whether to lend money.

## **Investment Considerations**

Purchasing a home offers several financial advantages to a buyer:

1. Possible long-term gain through appreciation
2. Increase in Equity as the mortgage is paid off

## **Determining Sellers Equity**

Your home equity is your personal financial investment in your home. The seller's home equity is the market value less any mortgage balance or existing liens.

- Equity increases with mortgage payments. Every time the homeowner makes a payment a portion of the payment goes to the principal amount and a portion towards the interest. The amount that goes to the principal is much smaller in the early years of the mortgage. The principal portion of the payment is what increases the equity.
- Equity increases with market appreciation.
- Home values increase as long as market conditions are healthy and the home appreciates over time.
- Equity increases with home improvements. Adding a bedroom, a bathroom or any improvement that adds square footage increases equity.

## **Tax Benefits**

Tax considerations may be an important part of any decision to purchase a home.

Homeowners may deduct from their income:

1. Some or all of the mortgage interest paid
2. Real estate taxes
3. Certain other expenses

New tax laws effective in 2019 have changed the traditional home-oriented tax benefits. A homeowner should consult with their tax preparer, accountant, or CPA to determine exactly how the new tax laws will affect their homeowner-oriented tax deductions.

## **Capital Gains Tax Exclusion - Sale of Real Estate**

Tax Laws now exclude all or a large portion of the gain (profit) from Capital Gains Taxes

1. \$500,000 is now excluded from capital gains tax for profits on the sale of a principal residence by married taxpayers who file jointly.
2. Taxpayers who file singly are entitled to a \$250,000 exclusion.
3. The exemption may be used repeatedly, as long as the homeowners have both owned and occupied the property as their residence for at least two of the past five years.

### Prorated Exclusion (From IRS)

Q: My wife and I bought a house two years ago, lived there for a year and one-half, then moved out. We continue to own the house and currently have a rental tenant. If we decide to sell the house, is there any way we can avoid tax on a capital gain? I know that you have to live in a house for two years to earn the full capital-gains exclusion, but I'm hoping that we can get it prorated.

A: There is a provision in the tax law that gives certain taxpayers a prorated exclusion. But I don't have enough information to determine whether you qualify.

To get a prorated exclusion, you would have to demonstrate that you were forced to move out of the house for a job-related or health reason. For example, your employer assigned you to another state. Or you suffered a disability that compelled you to move to a milder climate or a nursing home.

If that was the case, then you could claim three-fourths of the \$500,000 capital-gains exclusion to which a married couple is entitled. That's because you lived in the house for three-fourths of the normal two-year minimum period. (However, you would have to pay taxes on any depreciation after you began renting out the property).

Even if those special circumstances don't apply in your case, it is not too late for you to earn the full capital-gains exclusion. You can do that by moving back into the house for six more months.

The law doesn't require that your two-year residency be consecutive. As long as you make the house your principal residence for at least two of the five years before you sell it, you will qualify.

### IRA Use for Down Payment — No Penalty

First-time homebuyers may make penalty-free withdrawals from their tax-deferred individual retirement funds (IRAs):

1. For down payments on their homes.
2. Withdrawals are still subject to income tax.
3. The limit on such withdrawals is \$10,000
4. They must be spent entirely within 120 days on a down payment to avoid any penalty.

### Exchanges

Real estate investors can defer taxation of capital gains by making property exchanges. Even property that has appreciated greatly since its initial purchase may be exchanged for other property. A property owner will incur tax liability on a sale only if additional capital or property is also received; the tax is *deferred*, not *eliminated*. Whenever the investor sells the property, the capital gain will be taxed.

To qualify as a tax-deferred exchange, the properties involved must be of **like kind** as defined under Section 1031 of the Internal Revenue Code. The exchanged property must be a real estate of **equal value** and **same use**. Any additional capital or personal property included in the transaction to even out the value of the exchange is called **boot**.

**The IRS requires tax on the boot to be paid at the time of the exchange by the party who receives it.** The value of the boot is added to the basis of the property for which it is given. Tax-deferred

exchanges are governed by strict federal requirements, and competent guidance from a tax professional is essential.

### **Tax deductions**

Homeowners may deduct from their gross income any of the following:

- Real estate taxes (but not interest paid on overdue taxes)
- Mortgage interest payments on most first and second homes (the combined amount of acquisition indebtedness cannot exceed \$1,000,000, and the combined amount of home equity indebtedness cannot exceed \$100,000)
- Certain loan origination fees in the year of purchase (rules differ for refinancing and equity loans)
- Loan discount points in the year of purchase (whether paid by the buyer or the seller)
- Loan prepayment penalties

### **NOTE — Some costs are NOT allowed as Tax Deductions:**

1. Appraisal fees,
2. Notary fees,
3. Preparation costs,
4. Mortgage insurance premiums,
5. VA funding fees,
6. Points are deductible in the year of a house purchase if certain criteria are met.
7. Points are deducted over the life of the loan for a refinance.

These costs are **NOT** interest but are part of the cost of acquiring a home. When it is sold at a later date, these charges can be figured into the cost basis (Costs which can be added to the price of the home, which total is deducted from the selling price to determine the profit, for capital gains tax purposes).

## **HOMEOWNERS' INSURANCE**

### **Co-Insurance Clause**

Most homeowners' insurance policies contain a co-insurance clause. This provision usually **requires that the owner maintain insurance equal to a specified percentage (usually 80 percent)** of the replacement cost of the dwelling (not including the price of the land). An owner who has this type of policy may make a claim for the full cost of the repair or replacement of the damaged property without deduction for depreciation or annual wear and tear.

### **Examples of Claim Calculations**

A homeowners' insurance policy is for 80 percent of the replacement cost of the home or \$80,000. The home is valued at \$100,000, and the land is valued at \$40,000. The homeowner sustains \$30,000 in fire damage to the house. The homeowner can make a claim for the full cost of the repair or replacement of the damaged property without a deduction for depreciation. However, if the owner has insurance of only \$70,000, the claim will be handled in one of two ways, the owner will receive either actual cash value (replacement cost of \$30,000 less depreciation cost of say \$3,000, or \$27,000), or the claim will be prorated by dividing the percentage of replacement cost actually covered (0.70) by the



policy minimum coverage requirement (0.80). So, 0.70 divided by 0.80 equals 0.875, and \$30,000 multiplied by 0.875 equals \$26,250.

### **Subrogation**

A third party, such as an insurance company, often settles any covered insurance claim. When this happens, the third party generally acquires the right to any legal damages available to the insured. This right is called subrogation. (In other words, if a house burns down due to a utility company's negligence, and the insured accepts compensation from the insurance company, then the insurance company gains the rights related to possible further payment for damages from the utility company).

### **FEDERAL FLOOD INSURANCE PROGRAM**

**Homeowners' insurance policies always exclude floods, so flood coverage must always be purchased as a totally separate policy.**

The **National Flood Insurance Act of 1968** was enacted by Congress to help owners of property in flood-prone areas by subsidizing flood insurance and by taking land-use and land-control measures to improve future management for floodplain areas. The Army Corps of Engineers has prepared detailed maps that identify specific flood-prone areas throughout the country.

**To finance property with federal or federal-related mortgage loans, owners in flood-prone areas known as special flood hazard areas (SFHAs) are required to obtain flood insurance.**

**The Federal Emergency Management Agency (FEMA) administers the flood insurance program.**

Flood Insurance Policies are only issued by the Government. Policies are written annually and can be purchased from the National Flood Insurance Program (NFIP — a government agency), or the designated servicing companies in each state.

### **Flood Insurance: What's Covered and What's Not**

FEMA defines a flood as "a general and temporary condition of partial or complete inundation of two or more acres of normally dry land or two or more properties from an overflow of inland or tidal waves, an unusual and rapid accumulation or runoff of surface waters, mudflows or mudslides on the surface of normally dry land, or the collapse of land along the shore of a body of water."

The physical damage to a building or personal property directly caused by a flood is covered by flood insurance policies. **Flood policies exclude coverage for losses such as swimming pools, cars, money, animals, groundcover, or underground systems.**

Policies are of two types: replacement cost value (RCV) or actual cost value (ACV). Deductibles and premiums vary accordingly.

Notes:

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

## CHAPTER 2: OWNERSHIP, INTERESTS AND ENCUMBRANCES

### FORMS OF REAL ESTATE OWNERSHIP

Although the forms of ownership available are controlled by state laws, a fee simple estate may be held in three basic ways:

1. In **severalty**, where title is held by one individual
2. In **co-ownership**, where title is held by two or more individuals
3. In **trust**, where a third individual holds title for the benefit of another

### Ownership in Severalty

**Ownership in severalty occurs when property is owned by one individual or corporation.** The term comes from the fact that this sole owner is "severed" or "cut off" from other owners. The severalty owner has sole rights to the ownership and sole discretion to sell, will, lease, or otherwise transfer part or all of the ownership rights to another person.

Sole ownership of property is quite common in Illinois, and title held in severalty presents no unique legal problems. However, when either a husband or wife owns property in severalty, lenders, grantees, and title insurers in Illinois usually require that the non-owning spouse sign in order to release any potential homestead rights. This is true for both listing and sales contracts. *A non-owning spouse who is a minor, will also have to sign.*

### Co-Ownership

When title to one parcel of real estate is held by two or more individuals, those parties are called **co-owners or concurrent owners**.

### Undivided Interest (Ownership)

In Co-Ownership, the **physical** property, however, *is **not divided into a specific half or third***. Hence, it is called an undivided fractional interest. The co-owners have *unity of possession*, meaning they are entitled to *possession* of the whole property. It is the ownership interest, not the property, that is divided. **Three different owners cannot own a floor each in the three-floor flat they own.**

### Tenant in Common

A parcel of real estate may be owned by two or more people as tenants in common. In a **tenancy in common**, each tenant holds an undivided fractional interest in the property. A tenant in common may hold, for example, a one-half or one-third interest in a property.

### Some Features of Tenant in Common:

- If **no fractions are stated**, the tenants are presumed to hold **equal shares**. For example, if five people hold title, each would own an undivided one-fifth interest.
- Because the co-owners own separate interests, they can **sell, convey, mortgage, or transfer their individual interests without the consent of the other co-owners**.
- **No individual tenant may transfer the ownership of the entire property.**

- When **one co-owner dies**, the tenant's undivided interest passes according **to the co-owner's will, heirs, or living trust**.
- In Illinois, **Tenant in Common can be conveyed by a single deed** which may show the **proportional interests** of each tenant in common.
- When a **single deed** is used, **lack of a description of each tenant's share** means **all tenants hold equal, undivided shares**.
- In Illinois **Tenant in Common can be conveyed by a separate deed issued to each tenant in common** which shows his or her or their **individual proportional interest**.
- In Illinois, the law presumes that two or more owners hold title as **tenants in common** if the deed does **not state specifically** how title is to be held.

### Joint Tenancy

The unique feature of joint tenancy is **unity of ownership** and can be described as a **special bond between the owners**. **Each tenant holds an undivided fractional interest in the property**. In Joint Tenancy, all shares **must be equal**.

### Right of Survivorship — Joint Tenancy

#### Some features of the Right of Survivorship:

1. Ownership in Joint Tenancy cannot pass to their heirs on the death of the joint tenant.
2. Upon the death of a joint tenant, the deceased's interest transfers directly to the surviving joint tenant(s). Essentially, there is one less owner.
3. A will has no effect on a deceased joint tenant's property.
4. With each successive joint tenant death, the surviving joint tenants keep acquiring the deceased tenant's interest.
5. The joint tenancy continues until only one owner remains.
6. The last survivor takes title in severalty and has all the rights of sole ownership, including the right to pass the property to any heirs

### Creating Joint Tenancies

- A joint tenancy can be created only by the intentional act of conveying a deed or giving the property by will.
- It cannot be implied or created by operation of law.
- The deed must specifically state the parties' intention to create a joint tenancy
- The parties must be explicitly identified as joint tenants.

Four "unities" are required to create a joint tenancy:

1. Unity of ***possession*** - all joint tenants holding an undivided right to possession
2. Unity of ***interest*** - all joint tenants holding equal ownership interests
3. Unity of ***time*** - all joint tenants acquiring their interests at the same time
4. Unity of ***title*** - all joint tenants acquiring their interests by the same document

The four requirements for unities include the following:

1. Title is acquired by **one deed**.
2. The deed is executed and delivered at **one time**.

3. The deed conveys **equal interests** to all of the parties.
4. The parties hold **undivided possession** of the property as joint tenants.

Illinois allows a sole owner to execute a deed to herself and others "as joint tenants and not as tenants in common" in order to create a valid joint tenancy.

### **Tenancy by the Entirety – Special Joint Tenancy for Married Couples**

Illinois allows husbands and wives to use a special form of co-ownership called tenancy by the entirety for their **personal residence**.

1. Tenancy by the entirety is recognized in Illinois
2. In this form of ownership, each spouse has an equal, undivided interest in the property.
3. A husband and wife who are tenants by the entirety have rights of survivorship.
4. During their lives, they can convey title only by a deed signed by both parties.
5. One party cannot convey a one-half interest.
6. They have no right to partition or divide.
7. A lawsuit against one of the spouses will not put a lien on the house.
8. A married couple owning property by the entirety would be eligible for homestead protection in the event of a judgment against either the husband or wife
9. On the death of one spouse, the survivor automatically becomes the sole owner.
10. The surviving spouse enjoys the benefits of ownership without the delay of probate proceedings.

To create a tenancy by the entirety, the deed must indicate that the property is to be owned "not as joint tenants or tenants in common, but as tenants by the entirety."

The **Illinois Religious Freedom Protection and Civil Union Act** was signed into law on January 31, 2011. The act's purpose is to provide persons entering into a civil union with the "obligations, responsibilities, protections, and benefits as are afforded or recognized by the law of Illinois to spouses." **(750 ILCS 75/20)**. Civil union partners will be able to hold title to real property as tenants by the entirety after the act's effective date of June 1, 2011.

### **Termination of Tenancy by the Entireties**

A tenancy by the entirety may be terminated in several ways:

1. By a court-ordered sale of the property to satisfy a judgment against the husband and wife as joint debtors (the tenancy is dissolved so that the property can be sold to pay the judgment)
2. By the death of either spouse (the surviving spouse becomes the sole owner in severalty)
3. By agreement between both parties (through the execution of a new deed)
4. By divorce (which leaves the parties as tenants in common)

### Termination of Co-Ownership by Partition Suit

Partition is a **legal way to dissolve the relationship when the parties do not voluntarily agree** to its termination.

1. Cotenants who wish to terminate their co-ownership may file an **action in court** to partition the property.
2. If the court determines that the land cannot be divided physically into separate parcels without destroying its value, **the court will order the real estate sold.**
3. The proceeds of the sale will then be **divided among the co-owners according to their fractional interests.**

### Community Property

Community property laws are based on the idea that a husband and wife, rather than merging into one entity, are equal partners in the marriage. Under community property laws, any property acquired during a marriage is considered to be obtained by mutual effort.

### Illinois — Not a Community Property State

Illinois is a **marital property** state. Illinois has certain similarities to community property states but with important differences. Illinois, too, breaks property down into two major categories based on marital status:

**Marital** property - A husband and wife acquire joint rights in all property acquired after the date of marriage for the duration of the marriage, all of which will be divided between the two parties in the event of a divorce.

**Non-marital** property - Property that was acquired prior to the marriage or by gift or inheritance at any time, even during the marriage. If non-marital property is exchanged for other property, if it increases in value, or if it returns income, the exchange, increase, or income also would be considered non-marital property (property belonging to the individual).

If Non-marital property is **commingled with marital property**, however, a presumption of *transmutation* is created: **the resulting "mixed" property is presumed to be marital property.** The spouses may execute an express contract agreeing to exclude certain property from being classified as marital property.

### Trusts

A trust is a device by which: one person (**Trustor**) transfers ownership of property to someone else (Trustee)

- **Trustor owns the property**
- **Trustee** holds or manages the property for the **benefit of a third party (Beneficiary)**

The trustee is a **fiduciary**, who acts in confidence or trust and has a **special legal relationship with the beneficiary**. The trustee's power and authority are **limited by the terms of the trust agreement, will, or deed in trust.**

**Illinois permits real estate to be held in trust as part of a living or testamentary trust or as the sole asset in a land trust.**

### **Living and Testamentary Trusts**

A property owner may provide for her own financial care or for that of the owner's family by establishing a trust. This trust may be created by agreement **during the property owner's lifetime** (living trust, also called *inter vivos* trust) or established by will **after the owner's death** (testamentary trust).

The person who creates the trust conveys real or personal property to a trustee (usually a corporate trustee), with the understanding that the trustee will assume certain duties. These duties may include the **care and investment of the trust assets to produce an income**. After paying the trust's operating expenses and trustee's fees, the income is paid to or used for the benefit of the beneficiary. The trust may continue for the beneficiary's lifetime, or the assets may be distributed when the beneficiary reaches a certain age or when other conditions are met.

### **Land Trusts**

Illinois permits the creation of **land trusts**, in which **real estate is the only asset**. As in all trusts, the title to the property is conveyed to a trustee, and the beneficial interest belongs to the beneficiary. In the case of land trusts, however, **the beneficiary usually is also the trustor (original owner names himself as the Beneficiary)**. The **beneficiary retains management and control of the real property** and has the **right of possession and the right to any income or proceeds from its sale**.

### **Beneficial Interest — Beneficiary**

- The beneficial interest is **personal property**.
- One of the distinguishing characteristics of a land trust is that **public records usually do not name the beneficiary**.
- A land trust may be used for **secrecy** when assembling separate parcels. There are other benefits as well.
- A **beneficial interest in a land trust, being personal property, can be transferred by assignment**, making the formalities of **a deed unnecessary**.
- The beneficial interest in property can be pledged as security for a loan **without having a mortgage recorded**.
- The beneficiary's interest passes at the beneficiary's death under the laws of the state in which the beneficiary lived.

A land trust ordinarily **continues for a definite term, such as 20 years**. If the beneficiary does not extend the trust term when it expires, the trustee is usually obligated to sell the real estate and return the net proceeds to the beneficiary.

**Land trusts are used in Illinois. However, Illinois law requires that the trustee disclose the beneficiary's name to certain parties under specific circumstances. The beneficiary's name must be revealed:**

- to the concerned housing authority within ten days after receiving a complaint of a violation of a building ordinance or law,
- when applying to any state of Illinois agency for a license or permit affecting the entrusted real estate,
- if selling the entrusted property by land contract (seller financing),
- if the trustee is named as a defendant in a private lawsuit or criminal complaint regarding the subject real estate (the beneficiary's identity can then be "discovered" by the plaintiff),
- if a fire inspector or another officer is investigating arson.

### **Real Estate Investment Trust - Single Taxation**

A **real estate investment trust** does not have to pay corporate income tax as long as 95 percent of its income is distributed to its shareholders. To qualify as a REIT, at least 75 percent of the trust's income must come from real estate. Investors purchase certificates in the trust, which in turn invests in real estate or mortgages (or both). **Profits are distributed to investors without being taxed at the REIT level (Single Taxation).**

## **OWNERSHIP BY BUSINESS ORGANIZATIONS**

### **Partnerships**

A partnership is an association of two or more persons who carry on a business for profit as co-owners.

### **General Partnership**

All the partners participate in the operation and management of the business. **Each General Partner is solely responsible for the entire debt of the Partnership.** General partnerships are dissolved and must be reorganized if one partner dies, withdraws, or goes bankrupt.

### **General Partners**

- Manage the Limited Partnership (fee)
- Assume all risk for debt
- Contribute little capital
- Take a minor share of the profits

### **Limited Partnership**

Organization consists of one or more general partners and a rather large number of limited partners.

### **Limited Partners**

- No management role in Limited Partnership
- Liability limited to capital contribution
- Contribute most of the capital
- Take a major share of the profits



The limited partners are not legally permitted to participate in the management of the Limited Partnership. If they do, they are considered General Partners and assume liability for all of the risk. The limited partnership is a popular method of organizing investors because it permits investors with small amounts of capital to participate in large real estate projects with a minimum of personal risk.

**Illinois has adopted the federal Uniform Partnership Act (UPA), which permits real estate to be held in the partnership name. Profits and losses are passed through the partnership to each partner, whose individual tax situation determines the tax consequences (Single Taxation).**

## **Corporations**

A corporation is a **legal entity (an artificial person)** created under the authority of the laws of the state from which it receives its charter.

- A corporation is managed and operated by its *board of directors*.
- The **charter** sets forth the powers of the corporation, including its right to buy and sell real estate (based on a resolution by the board of directors).
- Because the corporation is a legal entity, it can own real estate in **severalty** or as a **tenant in common**. **It cannot hold property in a Life Estate because a corporation can exist indefinitely.**
- Some corporations are permitted by their charters to purchase real estate for any purpose, and others are limited to purchasing only the land necessary to fulfill the entities' corporate purposes.

**The creation and regulation of corporations in Illinois are governed by the Illinois Business Corporation Act.** As a legal entity, a corporation continues to exist until it is formally dissolved. **The death of one of the officers or directors does not affect title to property owned by the corporation.**

One of the main disadvantages of corporate ownership of income property is that the **profits are subject to double taxation**. As a legal entity, a corporation must file an income tax return and pay **tax on its profits**. The portion of the **remaining profits distributed** to shareholders as **dividends** are **taxed again as part of the shareholders' individual incomes**.

## **Subchapter S Corporations- Single Taxation**

An alternative form of business ownership that provides the benefit of a corporation as a legal entity but **avoids double taxation** is known as an S Corporation. Only the shares of the profits that are passed to the shareholders are taxed. The profits of the S Corporation are not taxed. Though there is **no limitation on the amount of corporate income** for an S Corporation, **the shareholders are limited to 100**.

## **Limited Liability Companies — Single Taxation**

The limited liability company (LLC) **combines the most attractive features of limited partnerships and corporations**. The members of an LLC enjoy the **limited liability offered by a corporate form of ownership** and the **tax advantages of a partnership**. In addition, the LLC offers flexible management structures without the complicated requirements of S corporations or the restrictions of limited partnerships.

**With passage of the Illinois Limited Liability Company Act in 1994, Illinois joined the majority of states that recognize limited liability companies as legitimate business organizations.**

### **Syndicates and Joint Ventures**

Generally speaking, a syndicate is **two or more people, or firms joined together to make and operate a real estate investment**. A syndicate is **not in itself a legal entity**; however, it may be organized into a number of ownership forms, including co-ownership (tenancy in common, joint tenancy), partnership, trust, or corporation.

A **joint venture** is a form of partnership in which **two or more people or firms carry out a single business project**. The joint venture is characterized by a **time limitation** resulting from the fact that the joint venturers do not intend to establish a permanent relationship.

### **ESTATES IN LAND**

An **estate in land** defines the degree, quantity, nature, and extent of an owner's interest in real property. Many types of estates exist, but not all interests in real estate are estates. **To be an estate in land, an interest must allow possession**, meaning the holding and enjoyment of the property either now or in the future, and must be **measured according to time**. Historically, estates in land have been classified primarily by their length of time of possession (i.e., as freehold estates and leasehold estates).

### **Freehold vs Leasehold Estates**

**Freehold estates last for an indeterminable length of time**, such as for a lifetime or forever. They include *fee simple* (also sometimes called an *indefeasible fee*), *defeasible fee*, and *life estates*. The first two of these estates continue for an indefinite period and may be passed along to the owner's heirs. A life estate is based on the lifetime of a person and ends when that individual dies.

**Leasehold estates last for a fixed period of time**. They include estates for years and estates from period to period. Estates at will and estates at sufferance also are leaseholds, though, by their operation, they are not generally viewed as being for fixed terms.

### **Freehold Estates**

#### **Fee Simple Estate**

Because fee simple estates are of **unlimited duration**, they are said to run "**forever**." Upon the death of the owner, a fee simple passes to the owner's heirs or as provided by a will. A fee simple estate is also referred to as an *estate of inheritance* (because that is how it passes unless the owner chooses to sell the property) or simply as fee *ownership*. There are two major divisions of fee ownership: fee simple absolute and fee simple defeasible.

**Fee simple absolute** is the **highest interest in real estate recognized by law**. Fee simple ownership is absolute ownership; the holder is entitled to all rights to the property. It is limited only by certain public and private restrictions, such as zoning laws and restrictive covenants.

**Fee simple defeasible** (or *defeasible fee*) estate is a **qualified estate** that is subject to the occurrence or nonoccurrence of some specified event. Two categories of defeasible estates exist:

1. those *subject to a condition subsequent*
2. those *subject to a fee simple determinable* (qualified by a special limitation).

### **Condition Subsequent — But if**

A fee simple estate may be qualified by a *condition subsequent*. This means that the new owner must not perform some action or activity. The former owner retains a *right* of re-entry so that *if the condition is broken, the former owner can retake possession of the property through legal action*.

An owner grants some land to a buyer "on the condition that there be no consumption of alcohol on the premises." This is a *fee simple subject to a condition subsequent*. If alcohol is consumed on the property, the former owner has the right to reacquire full ownership. **It will be necessary for the grantor (or the grantor's heirs or successors) to go to court to assert that right.**

### **Determinable — As Long As**

A fee simple determinable is a **fee simple defeasible estate that may be inherited**. This estate is qualified by a special limitation (which is an occurrence or event). The language used to distinguish a special limitation words such as ***so long as or while or during*** is the key to creating this special limitation. The former owner retains a ***possibility of reverter***. If the limitation is violated, the former owner (or heirs or successors) can reacquire full ownership with no need go the court. The deed is automatically returned to the former owner.

The right of reentry and possibility of reverter may never take effect. If they do, it will be only at some time in the future. Therefore, each of these rights is considered a **future interest**.

### **Life Estate**

**A Life Estate** is a freehold estate limited in duration to the life of the owner or the life of some other designated person or persons. Unlike other freehold estates, a life estate is **not inheritable**. It **passes to future owners according to the prearranged provisions of the life estate**.

**A life tenant** is entitled to the **rights of ownership** and can **benefit from both possession and ordinary use and profits arising from the ownership**, just as if the individual were a fee simple. **The life tenant's ownership may be sold, mortgaged, or leased, but it is always subject to the limitation of the life estate.**

The life tenant **may not injure the property**, such as by destroying a building or allowing it to deteriorate. In legal terms, **such injury is known as waste**. Those who eventually will own the property could seek an injunction against the life tenant or sue for damages if waste occurs.

Because the ownership will terminate on the death of the person against whose life the estate is measured, **a purchaser, lessee, or lender can be affected** if the life tenant has sold his rights. Because the interest is less desirable than a fee simple estate, **the life tenant's limited rights must be disclosed if the property is sold. The new purchaser will lose the property at whatever point in time the original life tenant would have lost it.**

### Conventional Life Estate

A **Conventional Life Estate** is created intentionally by the owner. It may be established either by **deed** at the time the ownership is **transferred during the owner's life or by a provision of the owner's will after the owner's death**. The estate is **conveyed to an individual who is called the life tenant**. The life tenant has full enjoyment of the ownership for the duration of his life. When the life tenant dies, the estate ends, and its **ownership passes, often as a fee simple, to another designated individual, or returns to the previous owner or owner's estate**.

### Pur Autre Vie

A life estate also may be based on the lifetime of a person other than the life tenant. This is known as a life estate *pur autre vie* ("for the life of another"). Although a life estate is not considered an estate of inheritance, a life estate *pur autre vie* provides for the life tenant's "ownership" only until the death of the person against whose life the estate is measured.

### Remainder Interest

The creator of the life estate may name a **remainderman** as the person to whom the property will pass when the life estate ends.

### Reversionary Interest

The creator of the life estate may choose **not to name a remainderman**. In that case, the **creator or the creator's estate will recapture ownership when the life estate ends**. The ownership is said to "revert to the original owner."

### Legal Life Estate

A **legal life estate is not created voluntarily by an owner**. Rather, it is a form of life estate **established by state law**. It becomes effective automatically when certain events occur. Dower, curtesy, and homestead are the legal life estates currently used in many states.

Dower and curtesy provide the non-owning spouse with a means of support after the death of the owning spouse. Dower is the life estate that a wife has in the real estate of her deceased husband. Curtesy is an identical interest that a husband has in the real estate of his deceased wife.

**Illinois has abolished the common law concepts of dower and curtesy in favor of the Uniform Probate Code**. This gives the surviving spouse the right to take what is called an ***elective share*** on the death of the other spouse.

### Homestead Right — Unsecured Creditors

A homestead is a legal life estate in real estate occupied as the family home. In effect, the home is protected from unsecured creditors during the occupant's lifetime. The homestead is not protected from real estate taxes levied against the property or from a mortgage for the purchase or cost of improvements. In other words, **if the debt is secured by the property, the property cannot be exempt from a judgment on that debt**.

**The homestead merely reserves a certain amount of money for the family in the event of a court sale.** On such a sale:

1. any debts secured by the home, such as a mortgage, unpaid taxes, or mechanics' liens are paid from the proceeds first.
2. **The family then receives the amount reserved by the homestead exemption.** Finally, whatever amount remains from the sale proceeds is applied to the family's unsecured debts, such as credit card debts.

**Every homeowner in Illinois is entitled to a homestead estate up to a value of \$15,000 for a single person and \$30,000 for a married couple. The estate extends to all types of residential property, including condominiums and cooperatives. Single persons, as well as householders with spouses and families, qualify.**

- No notice has to be recorded or filed to establish a homestead in Illinois.
- A family can have only one homestead at any one time.
- The Illinois homestead exemption is not applicable between co-owners.
- It is applicable to any co-tenant's unsecured creditors.
- The exemption continues after the death of an individual for the benefit of the surviving spouse as long as (s)he continues to occupy the homestead residence.
- It also extends for the benefit of all children living there until the youngest reaches 18 years of age.
- A release, waiver, or conveyance of homestead is not valid unless it is expressed in writing and signed by the individual and his spouse, if applicable.
- The signatures of both spouses are always required on residential sales contracts, listing agreements, notes, mortgages, deeds, and other conveyances to release possible homestead rights, even if the property in question is owned solely by either the husband or the wife.
- No sale would be ordered if the court could determine that nothing would remain from the proceeds for the unsecured creditors.

## LIMITATIONS ON THE RIGHTS OF OWNERSHIP

Even the most complete ownership the law allows is limited by public and private restrictions. These restrictions are intended to ensure that one owner's use or enjoyment of her property does not interfere with others' use or enjoyment of their property or with the welfare of the general public.

## GOVERNMENTAL POWERS

Ownership rights are subject to certain powers or rights held by federal, state, and local governments. These limitations on the ownership of real estate are **imposed for the general welfare of the community** and, therefore, **supersede the rights or interests of the individual**.

**The state and local government powers discussed in this section are all held by the state of Illinois and various county and municipal governing bodies.**

### Police Power

Every state has the power to enact legislation to:

1. Preserve order,

2. Protect public health and safety,
3. Promote the general welfare of its citizens.

That authority is known as a state's **police power**. The state's authority is passed on to municipalities and counties through legislation called *enabling acts*.

### **Eminent Domain**

Eminent Domain is the right of the government to **acquire privately owned real estate for public use**.

**Condemnation** is the process by which the government exercises this right, by judicial or administrative proceedings. **Just compensation** must be paid to the owner, and the rights of the property owner must be **protected by due process of law**.

Ideally, the public agency and the owner of the property in question agree on compensation through **direct negotiation**, and the government purchases the property for a price considered fair by the owner. In some cases, the owner may simply dedicate the property to the government as a site for a school, park, or another beneficial use. **In cases where the owner's consent cannot be obtained, the government agency can initiate condemnation proceedings to acquire the property.**

### **Quick Take**

Local units of government and quasi-governmental bodies are given the power of eminent domain by the **Illinois Constitution and by the Illinois Code of Civil Procedure**. In certain situations, Illinois law permits a summary proceeding in which a plaintiff/condemner may obtain immediate fee simple title to real property, including the rights of possession and use. Such a proceeding in Illinois is termed a quick take.

**In quick take, the plaintiff must deposit a sum with the county treasurer that is preliminarily considered by the court to be just compensation;** this can be litigated later. A quick take might be appropriate, for instance, when the state of Illinois or the Illinois Toll Highway Authority takes a property to construct, maintain, and operate highways, or an airport authority takes a property to provide additional land for an airport.

### **Delegation of Eminent Domain Power**

Generally, states delegate their power of eminent domain to quasi-public bodies and publicly held companies responsible for various facets of public service.

### **Supreme Court Redefinition of Eminent Domain**

In the past, the proposed use for taking property was to be **for the public good**. However, in June 2005, the U.S. Supreme Court in *Kelo v. City of New London*, significantly changed the definition of public use. **The court held that local governments could condemn homes and businesses for private or economic development purposes.**

### Illinois Law Refining Eminent Domain

The **Equity in Eminent Domain Act** became effective in Illinois on January 1, 2007, following the *Kelo v. New London* Supreme Court case. **The law places the obligation on the government to prove that an area is blighted** before forcing property owners to sell their property for private development projects. In addition, the act:

1. Helps property owners receive fair market value for their property,
2. Requires relocation costs for displaced residents and businesses,
3. Pays attorneys' fees when property owners successfully sue to keep their property.

**Taxation** is a charge on real estate to raise funds to meet the public needs of a government. Taxes on real estate include annual real estate taxes assessed by local and area governmental entities, including school districts; taxes on income realized by individuals and corporations on the sale of property, and special fees that may be levied for special projects. Nonpayment of taxes will give the government the power to claim an interest in the property.

**Escheat** (revert) is a process by which the state may acquire privately owned real or personal property. Illinois State law provides for ownership to transfer, or **escheat**, to the **County in which the property is located**, when an owner dies and leaves no heirs (as defined by the law), and there is no will or living trust instrument that directs how the real estate is to be distributed.

### ENCUMBRANCES

- An **encumbrance is a claim, charge, or liability that attaches to real estate.**
- An encumbrance **does not** have a possessory interest in real property.
- An encumbrance may decrease the value or obstruct the use of the property.
- An encumbrance is a right or an interest held by someone other than the property owner that **affects title to the real estate** but **does not necessarily prevent a transfer of title.**

**Encumbrances may be divided into two classifications:**

- Liens (usually monetary charges)
- Physical restrictions, easements, licenses, and encroachments

### Liens

A lien is a charge against property that provides security for a debt or an obligation of the property owner. If the obligation is not repaid, the lienholder is entitled to have the debt satisfied from the proceeds of a court-ordered or forced sale of the debtor's property. Real estate taxes, mortgages and trust deeds, judgments, and mechanics' liens all represent possible liens against an owner's real estate. Liens are discussed in depth in chapter 5.

### Deed Restrictions

**Deed restrictions are private agreements that affect land use. Once placed in the deed by a previous owner, they "run with the land,"** limiting the use of the property and binding to all grantees. Deed restrictions are enforced by an owner of real estate and are included in the seller's deed to the buyer.

### **Covenants, Conditions, and Restrictions (CC&Rs)**

These are private agreements that affect land use typically imposed by a developer or subdivider to maintain specific standards in a subdivision. CC&Rs are listed in the original development plans for the subdivision filed in the public record. **They may be enforced by the original owner, developer, or by a homeowners' association.**

### **Easements**

**An easement is the right to use the land of another for a particular purpose.** It may exist in any portion of the real estate, including the airspace above or a right-of-way across the land.

**An appurtenant easement** is attached to the ownership of one parcel and allows the owner the use of a neighbor's land. For an appurtenant easement to exist, **two adjacent parcels of land must be owned by two different parties.** The parcel over which the easement runs is known as the **servient tenement**; the neighboring parcel that benefits is known as the **dominant tenement.**

A **party wall** can be an exterior wall of a building that straddles the boundary line between two lots, or it can be a commonly shared partition wall between two connected properties. Each lot owner owns half of the wall on his lot, and each lot owner has an appurtenant easement in the other half of the wall. A written party wall agreement must be used to create the easement rights. Expenses to build and maintain the wall are usually shared. A fence built on the lot line is treated similarly.

### **Easement in Gross**

An easement in gross is an individual or company's interest in or right to use someone else's land, without being appurtenant to that land - rights-of-way or utility easements.

1. Commercial easements in gross may be assigned, conveyed, and inherited.
2. Personal easements in gross are usually not assignable.
3. Generally, a personal easement in gross terminates on the death of the easement owner.

### **Creating an Easement**

An easement is commonly created by a **written agreement between parties** that establishes the easement right. It may be created by the grantor in a deed of conveyance, in which the grantor either reserves an easement over the sold land or grants the new owner an easement over the grantor's remaining land.

### **Easement by Necessity**

An easement that is created when an owner sells a parcel of land that has **no access to a street or public way** except over the seller's remaining land is an easement by necessity.

An easement by necessity is **created by court order** based on the principle that **owners must have the right to enter and exit their land** the right of *ingress* (*enter*) and *egress* (*exit*); **they cannot be landlocked.**



### Easement by prescription

If the claimant has made use of another's land for a certain period of time as defined by state law, an easement by prescription, or a prescriptive *easement*, may be acquired. The claimant's use must have been:

1. continuous,
2. exclusive,
3. without the owner's approval ("adverse")
4. visible,
5. open,
6. notorious; that is, the owner must have been able to learn of it.

A visible fence, continuous gardening on the backlot, or driving over the property so often that ruts are visible are all examples.

To establish an easement by prescription in Illinois, the use must be adverse, exclusive, under a claim of right, and continuous and **uninterrupted for a period of 20 years**. Illinois law permits owners of pedestrian walkways in shopping centers and large commercial or industrial buildings to prevent the establishment of prescriptive easements by the public.

**To block the establishment of a prescriptive easement, the owner of any property must:**

1. display signs,
2. send a certified letter stating that access to or use of the property is by permission (and thus not adverse).

The concept of **tacking** provides that **successive periods of continuous occupation by different parties may be combined (tacked on)** to reach the required total number of years necessary to establish a claim for a prescriptive easement (20 years in Illinois).

### Easement by Condemnation

An easement by condemnation is acquired for a public purpose, through the right of *eminent domain*. The owner of the servient tenement must be compensated for any loss in property value.

### Terminating An Easement

**An easement terminates:**

- when the need no longer exists,
- when the owner of either the dominant or the servient tenement becomes the owner of both properties (also known as *termination by merger*),
- by release of the right of easement to the owner of the servient tenement,
- by **abandonment** of the easement (the intention of the parties is the determining factor),
- by non-use of a prescriptive easement,
- by destruction of the servient tenement,
- by lawsuit,
- by property conversion.

## License

A license is a **personal privilege** (not a right) to enter the land of another for a specific purpose. A **license can be terminated or canceled by the licensor (the person who granted the license) at any time**:

1. If the use of another's property is given orally or informally, it generally is considered to be a license rather than a personal easement in gross.
2. A license ends on the death of either party or the sale of the land by the licensor.

## Encroachments

**An encroachment occurs when all or part of a structure (such as a building, fence, or driveway) illegally extends beyond the land of its owner or beyond the legal building lines.** An encroachment usually is disclosed by either a **physical inspection of the property or a spot survey**.

## Spot Survey

A **spot survey shows the location of all improvements located on a property and whether they extend over the lot or building lines onto an adjoining property or an improvement on an adjoining property extends onto the property being surveyed.** A spot survey is more informational and useful than a simple *survey sketch* with only the lot dimensions. If a spot survey and physical inspection show that a building encroaches on adjoining land, the neighbor may be able to either:

1. recover damages,
2. or secure removal of the portion of the building that encroaches,

Unchallenged encroachments that last beyond a state's prescriptive period, however, may give rise to easements by prescription.

## CONDOMINIUMS, COOPERATIVES, TOWNHOUSES, AND TIME-SHARES

### Condominium Ownership

#### Two Types of Ownership in a Condominium

1. The owner of each unit holds a **fee simple title to the air space** described by the 3D survey.
2. The individual unit owners also **own a specified share of the undivided interest in the remainder of the building and land, known as the common elements, as Tenant in Common.**

**Common Elements** include:

- Land,
- Courtyards,
- Lobbies,
- The exterior structure,
- Hallways,
- Elevators,
- Stairways,
- Roof,
- Recreational facilities.

As such, each condominium owner has a **fractional, undividable interest in the common elements**, meaning the interest can be sold (along with the condo) but not any actual part of the common elements. **Illinois law provides, however, that unit owners do not have the same right to partition that other tenants in common have.**

### **Creation of a Condominium**

In Illinois, the creation of condominiums is governed by the Illinois Condominium Property Act (765 ILCS 605). Under this law, an owner/developer may elect to submit a parcel of real estate as a condominium situation by recording a declaration to which is attached a three-dimensional plat of survey of the parcel showing the location and size of all units in the building. Every unit purchaser acquires the fee simple title to the unit purchased, together with the percentage of ownership of the common elements that are set forth in the declaration and that belongs to that unit. This percentage is computed on the basis of the initial list prices of each unit.

### **3D Survey**

The survey required with each declaration of condominium ownership must indicate the dimensions of each unit. This survey will show the outlines of the lot, the size and shape of each unit, and the elevation or height above base datum for the upper surface of the floor level and the lower surface of the ceiling level. The difference between these two levels represents the **airspace owned in fee simple by the unit owner**.

Many Illinois municipalities have adopted conversion ordinances to protect tenants in rental buildings whose owners wish to convert to condominiums. The ordinances also protect prospective purchasers. These laws typically allow tenants an opportunity to extend their leases **and often guarantee first purchase rights**. Additional protections often include **disclosure of all material information, the structural soundness of the building, adequacy of parking, and a variety of other concerns**. These ordinances generally have been upheld by the courts as a valid exercise of police power.

### **Ownership of a Condominium**

Once the property is established as a condominium, each unit becomes a separate parcel of real estate that is owned in fee simple and may be held by one or more persons in any type of ownership or tenancy recognized by state law.

A condominium unit may be mortgaged like any other parcel of real estate. The unit can usually be sold or transferred to whomever the owner chooses unless the condominium association provides for a right of first refusal. In such a case, the owner is required to offer the unit at the same price to the other owners in the condominium or the association before accepting an outside purchase offer.

Real estate taxes are assessed and collected on each unit as an individual property. Default in the payment of taxes or a mortgage loan by one unit owner may result in a foreclosure sale of that owner's unit. One owner's default, however, does not affect the other unit owners.

### **Operation and Administration of a Condominium**

The condominium property is administered by an association of unit owners, often called a **homeowners' association (HOA)**. The association may be governed by a **board of directors** or another official entity, and it may manage the property on its own or hire a property manager.

The association must enforce any **rules it adopts regarding the operation and use of the property**. The association is responsible for the maintenance, repair, cleaning, and sanitation of the common elements and structural portions of the property. It also must maintain fire, extended coverage, and liability insurance.

**The expenses of maintaining and operating the building are paid by the unit owners in the form of fees and assessments.** Both fees and assessments are imposed and collected by the owners' association). Recurring fees (referred to as *assessments* or *condo fees*) are paid by each unit owner. The fees often are due monthly, but the schedule may be quarterly, semiannually, or annually, depending on the provisions of the bylaws. The size of an individual owner's fee is generally determined by the percentage of the unit's selling price in relation to the total of the selling price of all units when originally converted or built, but occasionally the percentage of square footage of the unit compared to the total square footage of all units in the condominium. **If the fees are not paid, the association may seek a court-ordered judgment to have the delinquent owner's unit sold to cover the outstanding amount.**

**Special assessments** are special payments required of unit owners to address some specific expenses, such as a new roof. Assessments are structured in the same way as condo fees, owners of larger units pay proportionately higher assessments.

These general condominium guidelines apply under the **Condominium Property Act in Illinois**. However, the property may be removed from condominium status at any time by the unanimous consent of all owners and all lienholders, as evidenced by a recorded written instrument. All owners would then be tenants in common.

### **Homeowners Association Regulations**

About 50 million U.S. homeowners belong to some sort of a homeowners' association. The purpose of an HOA is to protect its members and property values. If a real estate agent has a property listed that has an HOA, the agent needs a copy of the rules and regulations from the homeowners and should pass it on to any potential buyer since HOA rules and regulations vary between different HOAs.

Some basic duties include collecting HOA dues, enforcing code violations, and determining changes to the Covenants, Conditions, and Restrictions (CCR). A major benefit of an HOA is to protect property values as long as they are enforced by the association board. The CCR for an HOA are spelled out before you move in or purchase property. Everyone in an HOA must abide by the same code.

### **Cooperative Ownership**

In a cooperative, a **corporation holds title to the land and building. The corporation offers shares of stock to prospective tenants.**

The **price the corporation sets** for each apartment becomes the **price of the stock**. The purchaser becomes a **shareholder in the corporation** by virtue of this stock ownership and receives a **proprietary lease** to the apartment for the life of the corporation.

Because **stock is personal property**, the **cooperative tenant-owners do not own real estate.** Instead, they own an **interest in a corporation** that has only one asset, the building, which is **personal property**.

### **Operation and Management of a Co-Op**

The operation and management of a cooperative are determined by the corporation's bylaws. Through their control of the corporation, the shareholders of a cooperative control the property and its operation. **They elect officers and directors who are responsible for operating the corporation and its real estate assets.** Individual shareholders are obligated to abide by the corporation's bylaws.

An important issue in most cooperatives is the method by which shares in the corporation may be transferred to new owners. The bylaws may require that the board of directors approve any prospective shareholders. In some cooperatives, a tenant-owner must sell the stock back to the corporation at the original purchase price so that the corporation realizes any profits when the shares are resold. In others, if the stock is sold for the latest "going price" on the unit, stock profits may go to the departing tenant or at least be shared.

The corporation incurs costs in **operation and maintenance of the entire parcel**, including both the common property and the individual apartments. These costs include **real estate taxes and any mortgage payments the corporation may have.** The corporation also budgets funds for such expenses as insurance, utilities, repairs and maintenance, janitorial and other services, replacement of equipment, and reserves for capital expenditures. **Funds for the budget are assessed to individual shareholders, generally in the form of monthly fees similar to those charged by a homeowners' association in a condominium.**

Unlike in a condominium association, which has the authority to impose a lien on the title held by a unit owner who defaults on maintenance payments, **the burden of any defaulted payment in a cooperative falls on the remaining shareholders.** Each shareholder is affected by the financial ability of the others. For this reason, the approval of prospective tenants by the board of directors **frequently involves financial evaluation.** If the corporation is unable to make mortgage and tax payments because of shareholder defaults, the property might be sold by court order in a foreclosure suit. This could destroy the interests of all shareholders, including those who have paid their assessments.

### Advantages of Co-Op Ownership

Cooperative ownership, despite its risks, has become desirable in recent years for several reasons. Lending institutions view the shares of stock as acceptable collateral for financing. The availability of financing extends the possible transfer of shares to modest purchasers in many co-ops. As a tenant owner, rather than a tenant who pays rent to a landlord, the shareholder has some control over the property. Tenants in cooperatives also enjoy certain income tax advantages. The IRS treats cooperatives as it does fee simple interest in single homes or condominiums in regard to the deductibility of loan interest, property taxes, and home seller's tax exclusions. Finally, owners enjoy freedom from maintenance. **Illinois real estate licensees are permitted to list and sell cooperative units and interests without obtaining a securities license.**

### Townhouse Ownership

A townhouse is a popular form of housing in urban areas. The term *townhouse* is often used to describe any **type of housing connected by common walls**. In fact, the townhouse concept is a cross between single-family houses and apartments.

Title to each unit and lot is vested in the individual owner. Each owner also has a fractional interest in the common areas and is proportionately financially responsible. Common areas may include open spaces, recreational facilities, driveways, and sidewalks. The owner may sell, lease, will, or otherwise transfer the dwelling unit. The rights to the use of the common areas pass with the title.

### Time-Share Ownership

Time-share ownership permits multiple purchasers to buy interests in real estate, usually a resort property. Each purchaser receives the right to use the facilities for a certain period of time. A time-share estate includes a real property interest in condominium ownership; a time-share use is a contract right in which a third party retains ownership of the real estate. **In addition, pursuant to the Real Estate License Act of 2000, a person who engages in the sale of time-shares must have a real estate license.**

**Certain exemptions to the real estate licensing requirement apply.** An existing time-share owner who, for compensation, refers prospective purchasers, but only if the existing time-share owner:

1. refers no more than 20 prospective purchasers in any calendar year, receives no more than \$1,000, or its equivalent, for referrals in any calendar year,
2. limits his or her activities to referring prospective purchasers of time-share interests to the developer or the developer's employees or agents and does not show, discuss terms or conditions of purchase, or otherwise participate in negotiations with regard to time-share interests.

**A time-share estate is a fee simple interest.** The owner's occupancy and use of the property are **limited to the contractual period purchased**. The owner is **assessed for maintenance and common area expenses** based on the ratio of the ownership period to the total number of ownership periods in the property. Time-share estates **theoretically never end** because they are real property interests. However, the physical life of the improvements is limited and must be looked at carefully when considering such a purchase.

A time-share use consists of the right to occupy and use the facilities for a certain number of years. At the end of that time, the owner's rights in the property terminate. In effect, the developer has sold only a right of occupancy and use to the owner, not a fee simple interest.

**The Illinois Real Estate License Act requires:**

- That all developers and their agents must register with the IDFPR and hold a real estate license unless the licensee sells less than eight time-shares per year.
- A time-share listing agreement must provide for minimum requirements.
- Each purchaser must be given a detailed *public offering statement* before signing the contract.
- The statement discloses extensive information about the property, such as time periods, percentage of common expenses for each unit, use and occupancy restrictions, and the total number of units.
- In addition, disclosures to purchasers must include the status of assessments and real estate or personal property taxes. The statement also must include information about the developer and property management.

Any purchase contract entered into by a purchaser of a time-share interest shall be **voidable (rescindable)** by the purchaser, without penalty, within five calendar days after the receipt of the public offering statement or the execution of the purchase contract, whichever is later. The purchase contract shall **provide notice of the five-day cancellation period** as well as the name and mailing address to which any notice of cancellation shall be delivered.

Upon such cancellation, the developer or resale agent shall refund to the purchaser all payments made by the purchaser, less the amount of any benefits actually received pursuant to the purchase contract. The **refund shall be made within 20 calendar days** after the receipt of the notice of cancellation, or receipt of funds from the purchaser's cleared check, whichever occurs later.

**WATER RIGHTS**

Riparian and littoral rights are appurtenant (attached) to the land. The right to use the water belongs to whoever owns the bordering land and cannot be retained by a former owner after the land is sold.

**Riparian Rights are common law rights granted to owners of land along the course of a river, stream, or similar body of flowing water.**

An owner of land that borders a **non-navigable waterway** (that is, a body of water unsuitable for commercial boat traffic) **owns the land under the water to the exact center of the waterway.**

Land adjoining commercially **navigable rivers**, on the other hand, is usually **owned to the water's edge**, with the **state holding title to the submerged land**. Navigable waters are considered public waterways on which the public has an easement or right to travel.

**Littoral Rights**

Closely related to riparian rights are the littoral rights of owners whose land borders commercially navigable lakes, seas, and oceans. Owners own the land adjacent to the water only up to the mean

high watermark. All land below this point is owned by the public and can be used by the public when the water recedes below the mean high-water mark.

In some states where water is scarce, ownership and the use of water is often determined by the doctrine of prior appropriation. Under the doctrine, the right to use any water with the exception of limited domestic use, is controlled by the state rather than by the landowner adjacent to the water.

## ACCRETION, EROSION, and AVULSION

### Increase in Land

An owner is entitled to all land created through **accretion increases in the land resulting from the deposit of soil by the water's action**. Deposits are called *alluvion* or *alluvium*).

An owner is entitled to all land created through **reliction - increases in the land resulting from water receding**.

### Decrease in Land

**Erosion is the gradual and imperceptible wearing away of the land by natural forces such as wind, rain, and flowing water**. Fortunately, erosion usually takes hundreds of years to have any noticeable effect on a person's property. Flash floods or heavy winds can increase the speed of erosion.

**Avulsion is the sudden removal of soil by an act of nature**. It is an event that causes the loss of land much less subtly than erosion. A major earthquake or a mudslide, for instance, can cause an individual's land holdings to become much smaller very quickly.



Notes:

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## CHAPTER 3: LAND-USE CONTROLS

### Regulation

Land use is regulated by:

1. Public and Private Restrictions
2. Federal, State, and Local Governments.

### GOVERNMENT CONTROL

Most government controls on property occur at the local level.

### Police Power

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

### Home Rule

**Article VII of the Illinois Constitution** allows for home rule units of government. Any municipality with a population in **excess of 25,000** and any county that has a chief executive officer elected by the people are automatically home rule units. However, a home rule unit may elect by referendum not to be one. On the other hand, a municipality of fewer than 25,000 people may elect by referendum to become a home rule unit of government. **Townships are not allowed to be home rule units.**

**Constitutionally, a home rule unit of government may exercise any power and perform any function pertaining to its government, including the exercise of police power by way of laws that control the use of land.** If any ordinance of a **home rule county** conflicts with any ordinance of a **home rule municipality**, the municipal ordinance prevails.

**Township zoning ordinances** must give way to **county zoning ordinances**. **Townships are not empowered to pass subdivision controls or building codes.**

### The Comprehensive Municipality Plan

Local governments, municipalities, and counties establish development goals by creating a **comprehensive plan**. The comprehensive plan, also known as a **master plan**, is not a regulatory document but rather a **guide to planning for change** rather than reacting to proposals. The comprehensive plan:

- usually is long term, perhaps 20 years or longer,
- a general plan that can be revised and updated more frequently,
- plans for specific areas,
- strategic plans.

**Systematic planning for orderly growth consists of the following basic elements:**

- Land use, that is, a determination of how much land may be proposed for residence, industry, business, agriculture, traffic and transit facilities, utilities, community facilities, parks and recreational facilities, floodplains, and areas of special hazards
- Housing needs of present and anticipated residents, rehabilitation of declining neighborhoods, as well as new residential developments
- Movement of people and goods, highways and public transit, parking facilities, and pedestrian and bikeway systems
- Community facilities and utility, schools, libraries, hospitals, recreational facilities, fire and police stations, water resources, sewage, and waste treatment and disposal, storm drainage, and flood management
- Energy conservation to reduce energy consumption and promote the use of renewable energy sources

The preparation of a comprehensive plan involves surveys, studies, and analyses of housing, demographics, and economic characteristics and trends. A given municipality's planning activities may be coordinated with other government bodies and private interests to achieve orderly growth and development.

## ZONING

**Zoning** is a regulatory tool that helps communities regulate and control how land is used and limits the type of business in a given area.

**Zoning ordinances are local laws** that implement the comprehensive plan and regulate and control the use of land and structures within designated land-use districts. If the comprehensive or master plan is the big picture, zoning makes up the details.

**No nationwide or statewide zoning ordinances exist.** Rather, zoning powers are conferred on municipal governments by state enabling acts. State and federal governments may, however, regulate land use through special legislation, such as a scenic easement, coastal management, and environmental laws.

**Zoning affects such matters as:**

- permitted uses of each parcel of land,
- lot sizes,
- types of structures,
- building heights,
- **setbacks** (the minimum distance away from streets or sidewalks that structures may be built),
- style and appearance of structures,
- density (the ratio of land area to structure area), and
- protection of natural resources.

Zoning ordinances cannot be static; they must remain flexible to meet the changing needs of society.

## Zoning Objectives

**Land is divided into zones.** The zones are identified by a **coding system** that outlines how the land may be used according to the code. Common zoning classifications include:

- "C" for commercial,
- "R" for residential,
- "A" for agricultural,
- "M" for manufacturing,
- "B" for business.

There are subcategories in the classifications, and some land may be zoned for mixed-use.

A planned unit development (PUD) is a development where land is set aside for mixed-use purposes, such as residential, commercial, and public areas. Zoning regulations may be modified for PUDs.

**Zoning ordinances** have traditionally classified land use into:

- Residential,
- Commercial,
- Industrial,
- Agricultural.

These land-use areas are further divided into subclasses. Residential areas may be subdivided to provide for:

- detached single-family dwellings,
- semi-detached structures containing not more than four dwelling units,
- walk-up apartments,
- high rise apartments.

Some municipalities also use buffer zones to ease the transition from one use to another. **A buffer zone is typically a strip of land separating land dedicated to one use from land dedicated to another use.** For example, landscaped parks and playgrounds and hiking trails are used to screen residential areas from nonresidential zones.

Certain types of zoning that focus on special land-use objectives are used in some areas. These include:

- **bulk zoning (or density zoning)** to control density and avoid overcrowding by imposing restrictions such as setbacks, building heights, and percentage of open area or by restricting new construction projects,
- **aesthetic zoning** to specify certain types of architecture for new buildings, and
- **incentive zoning** to ensure that certain uses are incorporated into developments, such as requiring the street floor of an office building to house retail establishments.

## Constitutional issues and zoning ordinances

The ongoing question is how a local government can enact zoning ordinances that protect public safety and welfare without violating the constitutional rights of property owners. The government

provides a forum for the citizens to discuss zoning ordinances before they are enacted; these are called **public hearings**.

Any land-use **legislation** that is **destructive, unreasonable, arbitrary, or confiscatory** usually is considered **void**. Furthermore, zoning ordinances must not violate the various provisions of the state's constitution. Commonly applied tests in determining the validity of ordinances require that:

- power be exercised in a reasonable manner,
- provisions are clear and specific,
- ordinances are nondiscriminatory,
- ordinances promote public health, safety, and general welfare under the police power concept,
- ordinances apply to all property in a similar manner.

## Taking

The concept of taking is similar to eminent domain in that it comes from the **Takings Clause of the Fifth Amendment to the U.S. Constitution**. The clause reads, "...nor shall private property be taken for public use, without just compensation." Payment is referred to **as just compensation - compensation that is just and fair**. The compensation may be negotiated between the owner and the government, or the owner may seek a court judgment setting an amount based on appraisals. In general, no land is exempt from government seizure.

## Zoning Permits

Compliance with zoning can be monitored by requiring that property owners obtain permits before they begin any development. A permit will not be issued unless a proposed development conforms to the permitted zoning, among other requirements. Zoning permits are usually required before building permits can be issued.

## Zoning hearing board

Zoning hearing boards (or zoning boards of appeal) have been established in most communities to hear complaints about the effects a zoning ordinance may have on specific parcels of property. Petitions for variances or exceptions to the zoning law may be presented to an appeal board.

## Nonconforming use

Frequently, a lot or an improvement does not conform to the zoning law because it existed before the enactment or amendment of the zoning ordinance. Such a **nonconforming use** may be allowed to continue legally as long as it complies with the regulations governing nonconformities in the local ordinance or until the improvement is destroyed or torn down or the current use is abandoned. If the nonconforming use is allowed to continue indefinitely, it is grandfathered into the new zoning.

Real estate licensees should never assume, nor allow their clients to assume, that the existing nonconforming use will be allowed to continue. Buyers should verify with the local zoning authorities the conditions under which the use is allowed to remain or whether changes are permitted.

## Conditional-Use Permits and Variances

### Conditional Use Permit — Zoning Category existed before a Zoning Change

#### Variance — Current Zoning is being changed

A **conditional use permit** (also known as a special use permit) is usually granted to a property owner to allow a special use of property, defined as an allowable conditional use, within that zone, such as a house of worship or daycare center in a residential district. For a conditional use permit to be appropriate, the intended use must meet certain standards set by the municipality.

A **variance** (or exception), on the other hand, provides relief if zoning regulations deprive an owner of the reasonable use of the property. To qualify for a variance, the owner must demonstrate the unique circumstances that make the variance necessary. In addition, the owner must prove that (s)he is harmed and burdened by the current regulations. Any such variance is said to "run with the land," meaning the exception is passed on to any later owners after a change has been made.

Both variances and conditional-use permits are issued by zoning boards **only after public hearings**. The neighbors of a proposed use must be given an opportunity to voice their opinions.

## BUILDING CODES AND CERTIFICATES OF OCCUPANCY

### Building Codes

Most municipalities have enacted ordinances to **specify construction standards** that must be met when repairing or erecting buildings. These are called building codes, and they set the requirements for kinds of materials and standards of workmanship, sanitary equipment, electrical wiring, fire prevention, and similar issues.

### Building Permits

In addition to adhering to building codes, a property owner who wants to build a structure or alter or repair an existing building usually must obtain a **building permit**. Through the permit requirement, municipal officials are made aware of new construction or alterations and can verify compliance with building codes and zoning ordinances.

Inspectors will:

- closely examine the plans
- conduct periodic inspections of the work.
- after final inspection, the municipal inspector issues a **certificate of occupancy** or **occupancy permit**.

## SUBDIVISION & LAND DEVELOPMENT

Most communities have adopted **subdivision and land development ordinances** as part of their comprehensive plans. An ordinance includes provisions for submitting and processing subdivision plats. A major advantage of subdivision ordinances is that they encourage flexibility, economy, and ingenuity in the use of land.

A **subdivider** is a person who **buys undeveloped acreage(s)** and **divides it into smaller lots** for sale to individuals or developers or for the subdivider's own use.

A **developer** (who also may be a subdivider) **improves the land, constructs homes or other buildings on the lots, and sells them.** In a new residential subdivision, developers usually pay the costs to provide **new water, sewer, streets, curbs, and sidewalks.** Developing is generally a much more extensive activity than subdividing.

### **Land development plan**

Before the actual subdividing can begin, the subdivider must go through the process of **land planning.** The resulting land development plan must comply with the municipality's comprehensive plan. Although comprehensive plans and zoning ordinances are not necessarily inflexible, a plan that requires them to be changed must undergo more complicated hearings.

### **Plats**

From the land development and subdivision plans, the subdivider draws plats. **A plat is a detailed map that illustrates the geographic boundaries of individual lots.** It shows the blocks, sections, streets, public easements, and monuments in the prospective subdivision. A plat also may include engineering data and restrictive covenants. **The plats must be approved by the municipality before they can be recorded.**

Once a plat is properly recorded, it may be used as an adequate description of real property. A developer is often required to submit an **environmental impact report** with the application for subdivision approval. This report explains what effect the proposed development will have on the surrounding area. Plat maps are increasingly available for viewing on the Internet.

### **Subdivision Plans**

In plotting out a subdivision according to local planning and zoning controls, a **subdivider usually determines the size as well as the location of the individual lots.** The maximum or minimum size of a lot generally is regulated by local ordinances and must be considered carefully. Most subdivisions are laid out by the use of lots and blocks. An area of land is designated as a block, and the area making up this block is divided into lots.

### **Subdivision Density**

Zoning controls often include minimum lot sizes and population density requirements for subdivisions, which restrict the average maximum number of houses per acre that may be built within a particular subdivision. This average is called **gross density.**

### **Clustering for open space**

By slightly reducing lot sizes and clustering them around varying street patterns, a divider can house as many people in the same area as could be done using traditional subdividing plans but with substantially increased tracts of open space.

## PRIVATE LAND-USE CONTROLS

Not all restrictions on the use of land are imposed by government bodies. Certain restrictions to control and to maintain the desirable quality and character of a property or subdivision may be **created by private entities, including the property owners themselves. These restrictions are separate from and in addition to the land-use controls exercised by the government.** However, no private restriction can violate a local, state, or federal law.

### **Covenants, Conditions, and Restrictions (CC&Rs)**

These are private rules set up by the developer that set standards for all the parcels within the defined subdivision. CC&Rs are enforced by the homeowners' association.

**Unlike most deed restrictions, many CC&Rs have time limitations; for example, a restriction might state that it is "effective for a period of 25 years from this date."** After this time, it becomes inactive, or it may be extended if approved by the required number of owners. Many developers also include methods by which a required number of homeowners may change a CC&R.

Restrictive covenants are usually considered valid if they are reasonable restraints that benefit all property owners in the subdivision; that is, they protect property values or safety. **Restrictive covenants cannot be used for illegal purposes, such as for the exclusion of members of certain races, nationalities, or religions.**

Private land use controls may be more restrictive of an owner's use than the local zoning ordinances. **The rule is that the more restrictive of the two takes precedence.**

**Private restrictions can be enforced in court when one lot owner applies to the court for an injunction to prevent a neighboring lot owner from violating the recorded restrictions.** If adjoining lot owners stand idly by while a violation is committed, they can **lose the right to an injunction by their inaction.** The court might claim their right was lost through **laches** that is, the legal principle that **a right may be lost through undue delay or failure to assert it.**

**In Illinois, any restrictive covenant that forbids or restricts conveyance, encumbrance, occupancy, or lease on the basis of race, color, religion, or national origin is void. Exceptions to this section of the Illinois Human Rights Act are allowed for religious and charitable organizations.**

## REGULATION OF LAND SALES

Just as the sale and use of property within a state are controlled by state and local governments, **the sale of property in one state to buyers in another is subject to strict federal and state regulations.**



### **National Interstate Land Sales Full Disclosure Act**

The U.S. Congress created the federal **Interstate Land Sales Full Disclosure Act** to facilitate regulation of interstate land sales and to protect consumers from fraud and abuse in the sale or lease of land. The act required land developers to:

1. register subdivisions of 100 or more non-exempt lots with HUD, and
2. provide each purchaser with a disclosure document called a property report.

The property report contains relevant information about the subdivision and **must be delivered to each purchaser before the signing of the contract or agreement**. The report must disclose specific information about the land, including:

- the type of title being transferred to the buyer,
- the number of homes currently occupied on the site,
- the availability of recreation facilities,
- the distance to nearby communities,
- utility services and charges, and
- soil conditions and foundation or construction problems.

### **Right of Rescission**

Under the act, the purchaser has the right to revoke any contract to purchase a regulated lot until **midnight on the seventh day after the contract was signed**.

If the **purchaser or lessee does not receive a copy of the property report** before signing the purchase contract or lease, (s)he may bring an action to **void the contract within two years after signing it**.

### **Exemptions**

The act provides a number of exceptions. For instance, it does not apply to:

- subdivisions consisting of **fewer than 25 lots** or
- to those in which the **lots are of 20 acres or more**
- lots offered for sale **solely to developers**
- lots on which buildings exist or where a **seller is obligated to construct a building within two years**.

**Misrepresentation or failure to comply with the act's requirements subjects a seller to criminal penalties (fines and imprisonment} as well as to civil damages.**

### **State "Subdivided Land" Sales Laws**

The sale or promotion **within Illinois** of subdivided land is regulated by the **Illinois Land Sales Registration Act of 1999**. This act regulates the offering, sale, lease, or assignment of any improved or unimproved **land divided into 25 or more lots and offered as a part of a common promotional plan**. Under this legislation:

- subdividers must **register with the state**
- **file a full disclosure report** containing information on the land, location, tax status, financial arrangements, and liens associated with the offering.

As in the federal statute, in Illinois, a purchaser who receives the report prior to signing a contract or agreement may **cancel the contract or agreement** by giving notice to the seller any time before midnight of the **seventh day following the signing of the contract or agreement**. A purchaser in Illinois who **does not receive this report before a contract or agreement is signed** may cancel the contract or agreement anytime within **two years from the date of signing**.

Notes:

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## CHAPTER 4: LEGAL DESCRIPTION OF LAND

### Describing Land

A legal description is a detailed way of describing a parcel of land for documents such as deeds and mortgages that will be accepted in a court of law. The description is based on **information collected through a survey**, the process by which boundaries are measured by calculating the dimensions and area to determine the **exact location** of a piece of land.

Courts have stated that a description is **legally sufficient** if it allows a surveyor to locate the parcel. In this context, *locate* means that the surveyor must be able to define the **exact boundaries of the property**. **A street address will not tell a surveyor how large the property is or where it begins and ends.**

### METHODS OF DESCRIBING REAL ESTATE

Several alternative systems of identification have been developed to express a legal description of real estate. Three basic methods can be used to describe real estate:

1. Metes and bounds
2. Rectangular (or government) survey
3. Lot and block (recorded plat)

Although each method can be used independently, the **methods may be combined in some situations**. Some states use only one method; others use all three.

### Metes-and-Bounds Method

The metes-and-bounds method is the **oldest type of legal description**. **Metes mean distance**, and **bounds means compass directions or angles**. A metes-and-bounds description always starts at a designated place on the parcel, called the **point of beginning (POB)**. From there, the surveyor proceeds around the property's boundaries. The boundaries are recorded by referring to linear measurements, natural and artificial landmarks (called monuments), and directions. **A metes-and-bounds description always ends back at the POB so that the tract being described is completely enclosed.**

**Metes-and-bounds descriptions were used in the original thirteen colonies** and in those states that were being settled while the rectangular survey system was being developed. Today, as technology allows for greater precision and expanded record-keeping, there is greater integration of land description information.

**Monuments are fixed objects used to identify the POB, the ends of boundary segments, or the location of intersecting boundaries.** A monument may be a natural object, such as a stone, large tree, lake, or stream. It may also be a man-made object, such as a street, highway, fence, canal, or markers (iron pins or concrete posts) placed by surveyors. Measurements often include the words "more or less" because the location of the monuments is more important than the distances given in the wording. In other words, the **actual distance between monuments takes precedence over any linear measurements in the description.**

Metes-and-bounds descriptions are used in Illinois when describing irregular tracts, portions of a recorded lot, or fractions of a section. Such descriptions always incorporate the rectangular survey method and refer to the section, township, range, and principal meridian of the land.

### **Rectangular (Government) Survey System**

The rectangular survey system, sometimes called the government survey system, was established by Congress in 1785 to standardize the description of land acquired by the newly formed federal government. This system is based on two sets of intersecting lines: **principal meridians and baselines.**

Some features of the Rectangular Survey System:

- The principal meridians run north and south.
- The baselines run east and west.
- Both are located by reference to degrees of longitude and latitude.
- Each principal meridian has a name or number and is crossed by a baseline.
- Each principal meridian and its corresponding baseline are used to survey a definite area of land, indicated on the map by boundary lines.
- There are 37 principal meridians in the United States.
- Each principal meridian describes only specific areas of land by boundaries.
- No parcel of land is described by reference to more than one principal meridian.
- The meridian used is not necessarily the nearest one.

Locations in Illinois are described by their relation to one of three meridians — 2, 3, and 4. Note that only two of these three meridians actually run through Illinois (3 and 4), but nevertheless, all are sometimes referenced in legal descriptions for Illinois properties.

The **Second Principal Meridian** is located in Indiana and controls that portion of Illinois lying south and east of Kankakee.

The **Third Principal Meridian** begins at Cairo, at the junction of the Ohio and Mississippi rivers, and extends northward toward Wisconsin and near Rockford to the Illinois-Wisconsin border.

The **Fourth Principal Meridian** begins near Beardstown and extends northward to the Canadian border. Surveys of land located in the **western portion of Illinois use a baseline for the Fourth Principal Meridian at Beardstown.**

Surveys of land in Wisconsin and eastern Minnesota are made from the Fourth Principal Meridian using a baseline that is on the Illinois-Wisconsin border.

Not all property is described by reference to the nearest principal meridian. A property on the western border of the Third Principal Meridian and just west of Rockford will be described by reference to the Fourth Principal Meridian. There are no options with regard to the meridians and baselines used to describe a particular property; once made, a legal description is not changed.

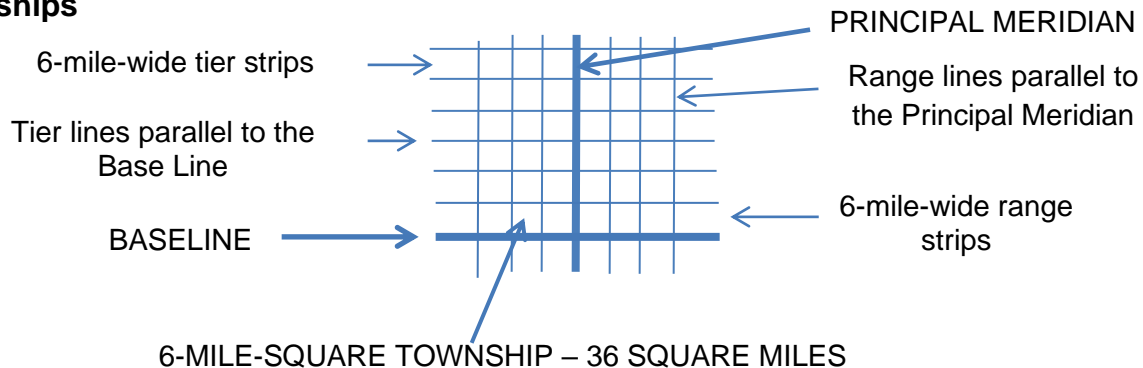
Further divisions are used in the same way as monuments in the metes-and-bounds method. They are:

- townships,
- ranges,
- sections, and
- quarter-section lines.

### Township Tiers

Lines running east and west, parallel to the baseline and six miles apart, are referred to as township lines. They form strips of land called township tiers. These township tiers are designated by consecutive numbers north or south of the baseline. For instance, the strip of land between 6 and 12 miles north of a baseline is Township 2 North.

#### Townships



### Township Ranges

The land on either side of a principal meridian is divided into six-mile-wide strips by lines running north and south, parallel to the meridian. These north-south strips of land are called ranges. They are designated by consecutive numbers east or west of the principal meridian. For example, Range 3 East would be a strip of land between 12 and 18 miles east of its principal meridian.

### Township Squares

**When the horizontal township lines and the vertical range lines intersect, they form squares.**

The 6-mile-square areas are called Townships. These township squares are the basic units of the rectangular survey system.

**Townships are six miles square and contain 36 square miles (23,040 acres).** For this discussion, the word **township** used by itself refers only to the township squares formed by the vertical range lines intersecting the tiers.

Each township is given a legal description. The township's description includes the following:

- Designation of the township tier in which the township is located
- Designation of the range strip
- Name or number of the principal meridian for that area

## Sections

Some features of Townships:

- Each township contains 36 sections.
- Each section is one square mile or 640 acres.
- Sections are numbered 1 through 36.
- Section 1 is always in the northeast or upper right-hand corner.
- The numbering proceeds right to left (backward), beginning in the upper right-hand corner. From there, the numbers drop down to the next tier and continue from left to right, then back from the right again to the left.
- By law, each section number 16 is set aside for school purposes. The sale or rental proceeds from section 16 were originally available for township school use. The schoolhouse was often located in this section, so it would be centrally located for all of the students in the township. As a result, Section 16 is always referred to as the school section.

## Correction Lines

Range lines are parallel only in theory. Due to the curvature of the earth, range lines gradually approach each other. If they are extended northward, they eventually meet at the North Pole. The fact that the earth is not flat, combined with the crude instruments used in the early days, means that few townships are exactly six-mile squares or contain exactly 36 square miles. The system compensates for this "round earth problem" with **correction lines. Every fourth township line, both north, and south of the baseline, is designated a correction line.** On each correction line, the range lines are measured to the full distance of six miles apart. Guide meridians run north and south at 24-mile intervals from the principal meridian.

## Fractional sections and government lots

**Undersized or oversized sections are classified as fractional sections.** Fractional sections may occur for a number of reasons. In some areas, for instance, the rectangular survey may have been done by separate crews, and gaps less than a section wide remained when the surveys met. Other errors may have resulted from the physical difficulties encountered in the actual survey. For example, part of a section may be submerged in water.

## Reading a rectangular survey description

To determine the location and size of a property described in the rectangular (or government) survey style, **start at the end, and work backward to the beginning. In other words, analyze the legal description right to left.** See the Math Section to determine how to calculate property sizes.

In general, if a rectangular survey description does not use the conjunction and or a semicolon (indicating two or more parcels are combined), the longer the description, the smaller the tract of land it describes.

Legal descriptions should always include the name of the county and state in which the land is located because meridians often relate to more than one state and occasionally relate to two baselines.

### **Metes-and-bounds descriptions within the rectangular survey system**

Land in states that use the rectangular survey system also may require a metes-and-bounds description. This usually occurs in one of three situations:

1. when describing an irregular tract,
2. when a tract is too small to be described by quarter-sections,
3. when a tract does not follow the lot or block lines of a recorded subdivision or section, quarter-section lines, or other fractional section lines.

**Metes-and-bounds descriptions may be included in the rectangular survey system used in Illinois when describing irregular or small tracts.**

### **Lot-and-Block System**

The third method of legal description is the lot-and-block (**recorded plat**) system. This system uses **lot-and-block numbers referred to in a plat map filed in the public records** of the county where the land is located. The lot-and-block system is often used to describe a property in subdivisions and urban areas.

A lot-and-block survey is performed in two steps:

1. First, a large parcel of land is described either by metes-and-bounds or by rectangular survey.
2. Once this large parcel is surveyed, it is broken into smaller parcels.

As a result, a lot-and-block legal description is always a **smaller part of a metes-and-bounds or rectangular survey description**. For each parcel described under the lot-and-block system, the lot refers to the numerical designation of any particular parcel. The block refers to a large part of the subdivision under which the map is recorded. When properly signed and approved, the subdivision plat is recorded in the county in which the land is located.

The plat becomes part of the legal description. In describing a lot from a recorded subdivision plat, three identifiers are used:

1. Lot-and-block number
2. Name or number of the subdivision plat
3. Name of the county and state

### **Illinois Plat Act**

Under the Illinois Plat Act, when an owner divides a parcel of land into two or more parts, any of which is less than five acres, the parts must be surveyed, and a plat of subdivision recorded. An exception to this would be the division of lots or blocks of less than one acre in any recorded subdivision that does not involve the creation of any new streets or easements of access. When a conveyance is made, the county recorder may require an affidavit that an exception exists.

The provisions of the Illinois Plat Act are complicated and subject to interpretation by each county recorder. Anyone attempting to record a document conveying land should consult a lawyer and the county recorder about the requirements involved.



## Legal Descriptions

A Licensed surveyor is the only one responsible for preparing a Legal Description. The legal description is part of a survey. This legal description is then copied into the Deed and Title Insurance documents on the closing of a real estate sale.

Legal descriptions should be copied with extreme care. An incorrectly worded legal description in a sales contract may result in a conveyance of more or less land than the parties intended. For example, damages suffered from an incorrect description could be extensive if buildings and improvements need to be moved because the land upon which the improvements were made is not owned. Often, even punctuation is extremely critical.

The **survey** shows the location and dimensions of the parcel and the legal description.

A **spot survey** shows the location and dimensions of the parcel and legal description, as well as the location, size, and shape of buildings and other improvements on the parcel. As a result, a **spot survey** shows all easements and possible encroachments of improvements onto the surveyed property or encroachments of improvements on the surveyed property onto an adjoining property and is required by a lender before closing a sale transaction.

Legal descriptions should not be altered or combined without adequate information from a surveyor or title attorney. The surveyor does this by preparing two documents: a boundary survey and a legal description.

It is especially important for real estate licensees to be aware of various surveys and their uses. Not all surveys include surveyor liability and warranties of accuracy. **Some surveys, such as an Improvement Location Certificate (ILC), are not full surveys**. ILCs are prepared in a shorter time frame and at less cost, providing only the location of the structures and improvements as related to property boundaries.

## Elevations

Just as surface rights must be identified, surveyed, and described, so must rights to the property above the earth's surface. **Elevations are measured to determine the legal descriptions of air rights and condominium apartments**. As discussed earlier, land includes the space above the ground. In the same way, land may be measured and divided into parcels, the air itself may be divided. **An owner may subdivide the air above his land into air lots**. Air lots are composed of the airspace within specific boundaries located over a parcel of land.

The condominium laws passed in all states require that a registered land surveyor prepare a plat map that shows the elevations of floor and ceiling surfaces and the vertical boundaries of each unit with reference to an official datum. A unit's floor, for instance, might be 60 feet above the datum, and its ceiling, 69 feet. Typically, a separate plat is prepared for each floor in the condominium building.

**Subsurface rights can be legally described in the same manner as air rights**. They are measured **below the datum** rather than above it. Subsurface rights are used not only for coal mining, petroleum drilling, and utility line location but also for multistory condominiums, both residential and commercial that have several floors below ground level.

## Datum

A **datum** is a **point, line, or surface from which elevations are measured** or indicated. For the purpose of the U.S. Geological Survey (USGS), datum is defined as the mean sea level at New York Harbor. However, virtually all large cities have local official datum that is used instead of the USGS datum. A surveyor would use a datum in determining the height of a structure or establishing the grade of a street. **The general datum plane used by Illinois surveyors is the USGS datum.**

## Land Measurements

Mile	5280 Feet
Square Mile	640 Acres
Acre	43,560 Square Feet
Yard	3 Feet
Square Yard	9 Square Feet
Cubic Yard	27 Cubic Feet
Square Foot	144 Square Inches
Township	36 Square Miles; 6 Miles Square
Section	1 Square Mile; 640 Acres

## Geometric Formulas

Area of rectangle =  $L \times W$

Area of triangle =  $\frac{1}{2} \text{ base} \times \text{height}$

Notes:

[illegible]

## CHAPTER 5: LIENS

### GENERAL LIEN INFORMATION

A lien is a **monetary charge or claim against property** that is made to enforce the payment of money. Whenever someone borrows money, the lender generally requires some form of security. *Security* (also referred to as *collateral*) is something of value that the borrower promises to give the lender if the borrower fails to repay the debt. When the lender's security is in the form of real estate, the security is called a lien.

A lien represents only an interest in property; it does not constitute **actual ownership of the property**. It is an *encumbrance* on the owner's title. An encumbrance is any charge or claim that attaches to real property and lessens its value or impairs its use. An encumbrance does not necessarily prevent the transfer or conveyance of the property, but because it is "attached" to the property, it transfers along with it. Liens differ from other encumbrances, however, because they are financial or monetary in nature and attach to the property because of a debt.

### Types of Liens

There are many different types of liens. One-way liens are classified is by **how they are created**.

- A **voluntary lien** is created intentionally by the property owner's action, such as when someone takes out a mortgage loan.
- An **involuntary lien**, on the other hand, is not a matter of choice; it is created by law. It may be either statutory or equitable.
- A **statutory lien** is created by statute. A real estate tax lien, then, is an involuntary, statutory lien. It is created by statute without the property owner taking it on voluntarily.
- An **equitable lien** is created by a court to ensure the payment of a judgment as well as by agreement.

Liens also may be classified according to **the type of property involved**.

- **General liens** affect **all the property, both real and personal, of a debtor**. This includes judgments, estate and inheritance taxes, decedent's debts, corporate franchise taxes, and Internal Revenue Service taxes.
- **Specific liens** are secured by **specific property** and affect **only that particular property**.

Specific liens on real estate include:

- mechanics' liens,
- mortgage liens,
- real estate tax liens,
- liens for special assessments and utilities,
- personal property, as when a lien is placed on a car to secure payment of a car loan.

## Effects of Liens on Title

The existence of a lien does not necessarily prevent a property owner from conveying title to someone else. **The lien might reduce the value of the real estate**, however, because few buyers will take on the risk of a property that has a lien on it.

Because the **lien attaches to the property, not the property owner**, a new owner could **lose the property if the creditors take court action** to enforce payment. Once properly established, **a lien runs with the land and will bind all successive owners until the lien is paid in full.**

## Priority of liens

Priority of liens refers to the order in which claims against the property will be satisfied. **In general, the rule for priority of liens is "first to record, first in right." Liens take priority from the date they are recorded in the public records of the county in which the property is located.**

There are some notable exceptions to this rule:

- Real estate taxes and special assessments generally take priority over all other liens, regardless of the order in which the liens are recorded. This means that outstanding real estate taxes and special assessments are paid from the proceeds of a court-ordered sale first. The remainder of the proceeds is used to pay other outstanding liens in the order of their priority.
- Mechanics' liens take priority as provided by state law but **never** over tax and special assessment liens.

## Subordination Agreements

These are written agreements between lienholders to change the priority of mortgage, judgment, and other liens. Under a subordination agreement, the holder of a superior or prior lien agrees to permit a junior lienholder's interest to move ahead of her lien.

## Real Estate Tax Liens

The ownership of real estate is always subject to certain government powers. One of these is the right of state and local governments to impose (levy) taxes to pay for their functions. Because the location of real estate is permanently fixed, the government can levy taxes with a high degree of certainty that the taxes will be collected. The annual taxes levied on real estate usually have priority over previously recorded liens, so they may be enforced by a court-ordered sale.

There are two types of real estate taxes:

1. general real estate taxes (also called ad valorem taxes)
2. special assessments (or improvement taxes).

## General Tax (Ad Valorem Tax)

**Ad valorem** is Latin for "**according to value.**" Ad valorem taxes are based on the **value of the property being taxed**. They are specific, involuntary, statutory liens. They are charged by various government agencies and municipalities, including:

- states,
- counties,

- cities, towns, and villages,
- school districts (local elementary and high schools, publicly funded junior colleges and community colleges)
- drainage districts,
- water districts,
- sanitary districts, and
- parks, forest preserves, recreation, and other public-use districts.

### **Exemptions from general taxes**

Most state laws exempt certain real estate from taxation. Such property must be used for tax-exempt purposes, as defined in the statutes. The most common exempt properties are owned by:

- various municipal organizations (such as schools, parks, and playgrounds),
- cities and counties,
- state and federal governments,
- religious and charitable organizations,
- hospitals, and
- educational institutions.

Many state laws also allow special exemptions to reduce real estate tax bills for certain property owners or land uses. For instance, **senior citizens frequently are granted reductions in the assessed values of their homes.**

**Properties in Illinois that are totally exempt from paying general real estate taxes include:**

- schools,
- religious institutions,
- cemeteries,
- charitable institutions,
- properties owned by federal, state, county, and local governments.

**Illinois property taxes are adjusted to reflect certain concessions given on owner-occupied residences.** These properties are designated as **homesteads**. The homestead exemption (not to be confused with the homestead estate) reduces the assessed value of a property subject to taxes. Here are the basic exemptions:

1. **The Homeowners' Exemption** applies to owners of single-family homes, condominiums, cooperatives, and one-to six-unit apartment buildings. The amount of exemption is currently \$6,000 (\$7,000 in Cook County)
2. **The Senior Citizen's Homestead Exemption** is available to homeowners over the age of 65. These exemption amounts are subtracted from the property's equalized assessed value before the tax rate is applied. This exemption reduces the equalized assessed value of a senior's home by \$5,000.
3. **The Senior Citizen's Assessment Freeze** Homestead Exemption program allows Illinois seniors to freeze their assessed valuation for the remainder of their lifetime once they have turned 65 if household income does not exceed \$55,000. Annual application and proof of income must be filed with the county assessor.

4. **The Homestead Improvement Exemption** allows any Illinois homeowner who has recently improved her home (by adding a new family room, for instance) to delay an increase in the home's overall assessed value for up to four years. This exemption is available up to an improvement value of \$75,000.

Property owners may qualify for other tax concessions based on their status as disabled veterans or by virtue of improvements to the property, certain maintenance and repair expenses, solar heating, airport land, farmland, rehabilitation of historic buildings, and location within enterprise zones or tax concession districts.

### **Assessment**

Real estate is valued for tax purposes by county or township assessors or appraisers. This official valuation process is called an assessment. A property's *assessed value* generally is based on the **sales prices of comparable properties**, although practices may vary. Land values may be assessed separately from buildings or other improvements, and different valuation methods may be used for different types of property. **In all counties except Cook, real property is assessed at 33⅓ percent of fair market value.**

### **Adjustment of Taxes**

Taxpayers who think that a mistake has been made in their property's assessment may:

- **file a complaint directly with the county assessor.**
- If the taxpayer's complaint is denied, the decision may be **appealed to an administrative board of review (in Cook County, the Board of Appeals)**.
- Alternatively, the taxpayer can bypass the county official and go directly to the board of review.
- If the taxpayer is dissatisfied with the board's decision, (s)he may appeal to the **Illinois Property Tax Appeal Board or to the circuit court of the county in which the property is located.**

### **Creating the tax bills**

After the budgets and value of the total property have been utilized to determine the tax rate, a property owner's tax bill is computed by applying the tax rate to the assessed valuation of the property.

Generally, one tax bill that incorporates all real estate taxes levied by the various taxing districts is prepared for each property. Some tax purposes or tax targets (like the park district) are split out and easily identifiable on most bills. In some areas, however, separate bills are prepared by each taxing body. **In Illinois, the county collector prepares and issues only one combined tax bill to each parcel of property.**

### **Validity of tax liens**

Real estate taxes must be valid to be enforceable. That means they must be levied properly, must be used for a legal purpose, and must be applied equitably to all property. Real estate taxes that have remained delinquent for the statutory period can be collected through various means.

## Annual Creation of the Tax Lien

General real estate taxes are levied annually for the calendar year and become a prior first lien, superior to all other liens, on January 1 of that tax year. However, they are **not due and payable until the following year**. In other words, Real Estate Taxes in Illinois are **paid in arrears**.

## Payment of Tax Bills

In all Illinois Counties, except Cook County, the first payment is due on June 1<sup>st</sup>, and the second installment is due on September 1<sup>st</sup>. In Cook County, the first payment (55% of the previous year's taxes) is due the first business day in March. The second payment (based on the final calculation of the annual taxes) is due sometime in October, possibly November (dates vary).

## Enforcement of the Tax Lien

The statutory requirements for the enforcement of tax liens are complex. When a property owner fails to pay taxes on real estate in Illinois, the property ultimately may be sold in one of three ways:

1. At an annual tax sale (Investor pays taxes for the owner)
2. At a forfeiture sale
3. At a scavenger sale

## Annual Tax Lien Sale (Solicitation of Investors to pay Delinquent Taxes)

If the taxes on a property have **not been paid by the due date of the second installment**, the county collector can enforce the tax lien and request that the circuit court order a tax sale. The county has notification requirements that are prescribed by statute. These requirements include:

- publication in a newspaper of general circulation within the community
- a certified or registered mailing to the last known address of the taxpayer.

The court will render judgment in favor of the county if the taxes are shown to be delinquent, and proper notice has been given. **The court order allows only the sale of the tax lien, not the property itself.**

**Prior to the time of sale**, the **owner and any other party with a legal interest** (except undisclosed beneficiaries of a land trust) may redeem the property and stop the sale by paying:

- the delinquent taxes,
- applicable interest,
- publication costs.

**Successful purchasers** at the sale are those who offer to pay:

- all outstanding taxes,
- interest,
- publication costs,
- processing charges,
- the county treasurer's indemnity fund fee.

If competitive bidding results, the **bid is for the lowest rate of interest that will be accepted by the bidder in case of redemption during the first six months of the redemption period**. The only persons not allowed to bid at the sale are owners, persons with legal interest, and/or their agents. The



successful bidder must pay with cash, cashier's check, or certified check. Upon payment, the purchaser receives a *certificate of purchase*. The **certificate will ripen into a tax deed if no redemption is made within the statutorily prescribed period.**

The statutory time period allowed for redemption on properties with six or fewer units is 2½ years from the date of sale. If the property is not redeemed by the owner within the period allowed, the tax sale purchaser is required to give notice to the delinquent owner and other parties who hold any interest in the property before applying for a tax deed.

### **Forfeiture Sale of the Property**

If there are no bids on a property at the annual tax sale, the property is forfeited to the state, although the title does not really change. The owner may still redeem the property after forfeiture by paying delinquencies, publication costs, and interest. On the other hand, **anyone who wants to purchase the property for the outstanding taxes may make an application to the county.** If this happens and the **owner does not claim the property within 30 days of notification**, the applicant will be issued a **certificate of purchase** once (s)he pays the outstanding taxes, interest, and other fees.

If **redemption is later made by the original owner**, the **certificate holder must be compensated** based on **12 percent interest for each six months** the certificate was held.

### **Scavenger Sale of the Property (also known as Assessor's Sale)**

If the **taxes have not been paid on a property for two years or more**, the property may be sold at a *scavenger sale*.

The county must go through the same court process as it would for tax sales and receive an order of sale. The **property is sold to the highest bidder**. The **buyer is not required to pay the tax lien** but must **pay current taxes**. In this case, former owners may not bid on their delinquent properties, either in person or through an agent, nor may individuals who are delinquent on their taxes by two or more years.

### **Special Assessments (Improvement Taxes)**

**Special assessments** are taxes levied on real estate **to fund public improvements to the property**. Property owners living nearest to the improvements are required to pay for them because their properties benefit directly from the improvements.

Special assessments are always specific and statutory, but they can be either involuntary or voluntary liens. Improvements initiated by a public agency create involuntary liens. However, when property owners petition the local government to install a public improvement for which the owners agree to pay (such as a sidewalk or paved alley), the assessment lien is voluntary.

Special assessments usually are due in equal annual installments, plus interest, over a period of five to ten years, with the first installment usually due during the year following the public authority's approval of the assessment. The first bill includes one year's interest on the property owner's share of the entire assessment; subsequent bills include one year's interest on the unpaid balance. Property owners have the right to

prepay any or all installments to avoid future interest charges. **The annual due date for assessment payments in Illinois is generally January 2.**

**Special Service Areas (SSAs)** are special taxing districts in municipalities that are established by ordinance, often at the **request of developers of new housing subdivisions**, in order to pass on the costs of the streets, landscaping, water lines, and sewer systems to homeowners who reside within the SSA. The **SSA assessments pay off the municipal bonds that are issued to pay for the infrastructure**. Assessments are billed annually on property tax bills, generally for a period of 20 to 30 years.

## OTHER LIENS

### **Mortgage Liens (Deed of Trust Liens)**

A **mortgage lien**, sometimes called a *deed of trust lien*, is a **voluntary lien on real estate given to a lender by a borrower as security for a real estate loan**.

It becomes a lien on real property when the lender records the documents in the county where the property is located. Lenders generally require a preferred lien, referred to as a ***first mortgage lien***. This means that no other liens against the property (aside from real estate taxes) would take priority over the mortgage lien. Subsequent liens are referred to as ***junior liens***.

### **Mechanics' Liens**

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

A mechanic's lien is available to contractors, subcontractors, architects, equipment lessors, surveyors, laborers, and other providers. This type of lien is **filed when the owner has not fully paid for the work** or when the **general contractor has been compensated but has not paid the subcontractors or material suppliers**.

To be entitled to a mechanic's lien, the person who did the work **must have had a contract (express or implied) with the owner** or the owner's authorized representative. Releases of lien or lien waivers should be sought by the owner for whom the work was performed or material supplied, once work is paid (partially or fully), with signatures from the general contractor and the subcontractors.

A "no-lien contract" filed on the project precludes any liens. If improvements that were not ordered by the property owner have commenced, the property owner may execute a document called a notice of non-responsibility to attempt to relieve herself from possible mechanics' liens. By posting this notice in some conspicuous place on the property and recording a verified copy of it in the public record, the owner gives notice that she is not responsible for the work done.

**Contractors with unpaid bills who wish to enforce their lien rights against an owner must file their lien notices within four months after the work is completed. Subcontractors have the right in Illinois to file for their unpaid claims as well, even when the general contractor has been paid in full.**

Under the **Illinois Mechanic's Lien Act** notice requirements, a contractor who makes improvements to an owner-occupied, single-family residence must give the owner written notice within ten days after recording a lien against any property of the owner. If timely notice is not given and, as a result, the owner suffers damages before a notice is given, the lien is extinguished to the extent of the damages. The mere recording of the lien claim is not considered damages. The amendment specifically applies to contractors and not to subcontractors.

Mechanics' liens can take priority over a previously recorded lien if the work done has enhanced the value of the property. The lien attaches as of the date when the work was ordered, or the contract was signed by the owner. The date of signing of the contract or the start of work establishes the lien's priority over other liens. From the point of view of the public or a prospective purchaser, an unpaid contractor has a "secret lien" until the notice is recorded.

### **Lien Waiver and Disclaimer**

The names of all subcontractors must be listed by the general contractor in a sworn statement. This list is presented to the landowner who ordered the work. Lien Waivers (or *waivers of lien*) should be collected by the landowner from each contractor and subcontractor to create a continuous record that all lien claimants have released their lien rights. Materials suppliers and property managers should also be approached for releases.

### **Expiration of lien right and commencement of suit**

In Illinois, the contractor's lien right will **expire two years after completion of that contractor's work**, unless (s)he files suit within that time to foreclose the lien. Suits to enforce mechanic's liens must be filed **within two years after the last labor and/or materials were supplied**. Under Section 34 of the **Illinois Mechanic's Lien Act**, a property owner can demand that the suit be commenced in 30 days. **This suit can force the sale of the real estate through a court order to provide funds to pay the claimant's lien.**

### **Judgments**

A **judgment** is an order issued by a court that settles and defines the rights and obligations of the parties to a lawsuit. When the judgment establishes the amount a debtor owes and provides for money to be awarded, it is referred to as a money judgment.

**A judgment is a general, involuntary, equitable lien on both real and personal property owned by the debtor.** A judgment is not the same as a mortgage because no specific parcel of real estate was given as security at the time the debt was created. **A lien usually covers only property located within the county in which the judgment is issued.** As a result, a notice of the **lien must be filed in any county to which a creditor wishes to extend the lien coverage.**

A judgment becomes a general lien on all the defendant's real and personal property in a county at the time the judgment is recorded in the county recorder's office. For the lien to be effective in another county, a memorandum of judgment must be recorded in that county. **Judgment liens are effective in Illinois for seven years and may be renewed for another seven-year term.**

To enforce an actual judgment, the **creditor must obtain a writ of execution from the court**. A writ of execution directs the sheriff to seize and sell as much of the debtor's property as is necessary to pay both the debt and the expenses of the sale. A judgment does not become a lien against *personal* property (as opposed to real property) of a debtor until the creditor orders the sheriff to levy the property, and the levy actually is made.

### **Lis pendens**

There is often a considerable delay between the time a lawsuit is filed, and the time final judgment is rendered. **When any suit is filed that affects title to real estate**, a **special notice** known as a **lis pendens** (Latin for "litigation pending") is recorded. A lis pendens is not itself a lien but rather **notice of a possible future lien**. **Recording a lis pendens notifies prospective purchasers and lenders that there is a potential claim against the property**. It also establishes a priority for the later lien: the lien is backdated to the recording date of the lis pendens.

### **Attachments**

Special rules apply to realty that is not mortgaged or similarly encumbered. To prevent a debtor from conveying title to such previously unsecured real estate while a court suit is being decided, a creditor may seek a writ of attachment. By this writ, the **court retains custody of the property until the suit concludes**. First, the creditor must post a surety bond or deposit with the court. The bond must be sufficient to cover any possible loss or damage the debtor may suffer while the court has custody of the property. In the event the judgment is not awarded to the creditor, the debtor will be reimbursed from the bond.

### **Estate and Inheritance Tax Liens**

Federal estate taxes and state inheritance taxes (as well as the debts of decedents) are general, statutory, involuntary liens **that encumber a deceased person's real and personal property**. These are normally paid or cleared in probate court proceedings.

### **Bail Bond Lien**

A real estate owner who is charged with a crime for which (s)he must face trial may post bail in the form of real estate rather than cash. **The execution and recording of such a bail bond creates a specific, statutory, voluntary lien against the owner's real estate**. If the accused fails to appear in court, the lien may be enforced by the sheriff or another court officer.

### **IRS Tax Lien**

A federal tax lien, or Internal Revenue Service (IRS) tax lien, results from a person's failure to pay any **portion** of federal taxes, such as income and withholding taxes. A federal tax lien is a general, statutory, involuntary lien **on all real and personal property held by the delinquent taxpayer**. Its priority, however, is based on the date of filing or recording; it does not supersede previously recorded liens.

### **Commercial Real Estate Broker Lien**

The **Commercial Real Estate Broker Lien Act** permits commercial sponsoring brokers to place a lien on property in the amount of the commission they are entitled to receive for leasing, as well as for a sale under a written brokerage agreement in the event they are not paid for their services. The lien applies to commercial property only, and it must be recorded before closing to be enforceable.

**NOTES:**

[illegible]

## CHAPTER 6: REAL ESTATE FINANCING

### MORTGAGES

A mortgage is a **voluntary lien** on real estate. The person who borrows money to buy a piece of property voluntarily gives the lender the right to take that property if the borrower fails to repay the loan. The borrower, or **mortgagor**, pledges the land to the lender, or **mortgagee**, as security for the debt. Exactly what rights the mortgagor gives the mortgagee vary from state to state.

#### Title-theory States,

Here the **mortgagor actually gives legal title to the mortgagee** (or some other designated individual) and retains **equitable title**. Legal title is returned to the mortgagor when the debt is paid in full (or some other obligation is performed). In theory, the lender actually owns the property until the debt is paid. The lender allows the borrower all the usual rights of ownership, such as possession and use. Because the lender holds legal title, the lender has the right to immediate possession of the real estate and rents from the mortgaged property if the mortgagor defaults.

#### Lien-theory States

In this case, **the mortgagor/borrower holds legal title**. The **mortgagee/lender simply has a lien on the property as security for the mortgage debt, or equitable title**. The mortgage is nothing more than **collateral for the loan**. If the mortgagor defaults, the mortgagee must go through a formal *foreclosure* proceeding to obtain legal title. The property is offered for sale, and sale proceeds are used to pay all or part of the remaining debt. In some states, a defaulting mortgagor may redeem the property during a certain period after the sale. A borrower who fails to redeem the property during that time loses the property irrevocably.

#### Illinois - Intermediate Mortgage Theory State

**Illinois does not adhere strictly to either the title or lien theory.** Illinois recognizes both a Mortgage approach (Buyer gets title to the property) and Deed of Trust (Lender has title to the property). As a result, Illinois often is referred to as an **intermediate mortgage theory state**. Where a Mortgage is used, the mortgagor/borrower remains the owner of the mortgaged property subject to the lien created by the mortgage. **Although most of the real estate transactions in Illinois involve a Mortgage approach, because a Deed of Trust CAN be used in Illinois, Illinois is considered to be an Intermediate Theory State.** In fact, most of the lending transactions in Illinois utilize a mortgage instrument, not a deed in trust.

Where a Mortgage is used (Buyer has Title to the property), the lender is subject to the **defeasance clause**, which stipulates that the lien on the property is released by the Lender (Mortgagee) at the time the debt is repaid in full.

#### Mortgage Loans

A mortgage loan, like all loans, creates a relationship between a debtor and a creditor. In the relationship, the creditor loans the debtor money for some purpose, and the debtor agrees to pay or pledges to pay the principal and interest according to an agreed schedule. The debtor agrees to offer some property or collateral to the creditor if the loan is not repaid.

Mortgage loans are secured loans. Mortgage loans have two parts:

- the debt itself
- the security for the debt.

When a property is mortgaged, the owner must execute (sign) two separate instruments:

- a promissory note stating the amount owed
- a security document (mortgage), pledging the property as collateral for the amount owed.

**Hypothecation** In mortgage lending practice, a borrower is required to pledge specific real property as security (collateral) for the loan. The **debtor retains the right of possession and control**, while the creditor receives an underlying equitable right in the pledged property. This type of pledging is termed hypothecation. The right to foreclose on the pledged property in the event a borrower defaults is contained in a security agreement, such as a mortgage or a deed of trust.

### Promissory Notes

The promissory note, referred to as the **note or financing instrument**, is the **borrower's personal promise to repay a debt according to agreed terms**. The note exposes all the borrower's assets to claims by secured creditors. The mortgagor executes one or more promissory notes to total the amount of the debt. **A promissory note executed by a borrower (known as the maker or payor) is a contract complete in itself.**

It generally states the:

- amount of the debt,
- the time and method of payment,
- rate of interest.

When signed by the borrowers and other necessary parties, the note becomes a legally enforceable and fully negotiable instrument of debt. When the terms of the note are satisfied, the debt is discharged. If the terms of the note are not met, the lender may choose to sue to collect on the note or to foreclose.

A note need not be tied to a mortgage or a deed of trust. A note used as a debt instrument without any related collateral is called an **unsecured note**. Unsecured notes are used by banks and other lenders to extend short-term personal loans.

A note is a negotiable instrument like a check or bank draft. The lender who holds the note is referred to as the *payee* and **may transfer the right to receive payment to a third party** in one of two ways:

- By signing the instrument over (that is, by *assigning it*) to the third party
- By delivering the instrument to the third party

### Interest

**Interest is a charge for the use of money.** Interest may be due at either the end or the beginning of each payment period. Payment made at the beginning of each period is payment in **advance**. When payments are made at the end of a period, it is known as payment in **arrears**. Whether interest is charged in arrears or in advance is specified in the note. This distinction is important if the property is sold before the debt is repaid in full. Most mortgages have interest in arrears.



## Usury

**Charging interest in excess of the maximum rate allowed by law is called usury.** To protect consumers from unscrupulous lenders, many states have enacted laws limiting the interest rate that may be charged on loans. In some states, the legal maximum rate is a fixed amount. In others, it is a floating interest rate that is adjusted up or down at specific intervals based on a certain economic standard such as the prime lending rate or the rate of return on government bonds.

Whichever approach is taken, lenders are penalized for making usurious loans. In some states, a lender that makes a usurious loan is permitted to collect the borrowed money but only at the legal rate of interest. In others, a usurious lender may lose the right to collect any interest or may lose the entire amount of the loan in addition to the interest. In Illinois, there is no legal limit specifically imposed on the rate of interest that a lender may charge a borrower when the loan is secured by real estate.

## Loan origination fee

The **processing** of a mortgage application is known as **loan origination**. When a mortgage loan is originated, a **loan origination fee** is charged by most lenders to cover the **expenses** involved in generating the loan. These include the loan officer's salary, paperwork, and the lender's other costs of doing business. **A loan origination fee is not prepaid interest**; rather, it is a charge that must be paid to the lender. While a loan origination fee serves a different purpose from discount points, both increase the lender's yield. Therefore, the federal government treats the fee, like discount points. It is included in the annual percentage rate of Regulation Z, and the **IRS lets a buyer deduct the loan origination fee as interest paid up-front**.

## Discount points

A lender may sell a mortgage to investors (discussed later in this chapter). However, the interest rate that a lender charges the borrower for a loan might be less than the yield (true rate of return) an investor demands. To make up the difference, the lender charges the borrower **discount points**.

The number of points charged depends on two factors:

- The difference between the mortgage loan interest rate and the required investor yield
- How long the lender expects it will take the borrower to pay off the loan

**For the borrowers, one discount point equals 1 percent of the loan amount** and is charged as prepaid interest at the closing. For instance, three discount points charged on a \$100,000 loan would be \$3,000 ( $\$100,000 \times 3\%$ , or 0.03). If a house sells for \$100,000 and the borrower seeks an \$80,000 loan, each point would be \$800. In some cases, however, the points in a new acquisition may be paid in cash at closing rather than being financed as part of the total loan amount.

## Prepayment Penalty

The amount of accrued interest is carefully calculated during the origination phase to determine the profitability of each loan. If the borrower repays the loan before the end of the term, the lender collects less than the anticipated interest. For this reason, some mortgage notes contain a prepayment clause. **This clause requires that the borrower pay a prepayment penalty against the unearned portion of the interest for any payments made ahead of schedule.**

**Note: Lenders may not charge prepayment penalties on mortgage loans insured or guaranteed by the federal government or on those loans that have been sold to Fannie Mae or Freddie Mac.**

Lenders in Illinois are prohibited from charging a borrower a prepayment penalty on a fixed-rate loan secured by residential real estate when the loan's interest rate is greater than 8 percent per year. However, they can charge a prepayment penalty on an adjustable-rate loan.

## DEED OF TRUST

As previously stated, a **promissory note does need to be tied to either a mortgage or a deed of trust**. In Illinois, the note used to obtain money to purchase real property is usually secured by a mortgage.

The mortgage document or deed of trust clearly establishes:

- that the property is security for a debt,
- identifies the lender and the borrower,
- includes an accurate legal description of the property.

### Deed of Trust

In some situations, lenders may prefer to use a **three-party instrument known as a deed of trust, or trust deed**, rather than a mortgage.

- A deed of trust conveys naked title or bare legal title, that is, title without the right of possession.
- The deed is given by the buyer-borrower (Trustor), as security for the loan to a third party, called the Trustee.
- The trustee holds title on behalf of the lender, who is known as the Beneficiary.
- The Beneficiary is the holder of the note.

The conveyance establishes the actions that the trustee may take if the borrower (the trustor) defaults under any of the deed of trust terms.

### Provisions for Default

The mortgage or deed of trust typically includes an **acceleration clause** to assist the lender in foreclosure. If a borrower defaults, the lender has the right to "accelerate the maturity of the debt." This means the **lender may declare the entire debt due and payable immediately. Without an acceleration clause, the lender would have to sue the borrower every time a payment was overdue.**

Other clauses in a mortgage or deed of trust:

- enable the lender to take care of the property in the event of the borrower's negligence or default.
- If the borrower does not pay taxes or insurance premiums the lender may step in and do so.
- The lender has the power to protect the security (the real estate).

- Any money advanced by the lender to cure a default may be either added to the unpaid debt or declared immediately due from the borrower.

### Discount Points and Investor Yield

As a general guideline, each discount point paid to the lender will increase the lender's yield (return) by approximately  $\frac{1}{8}$  of 1 percent (.00125). In using the guideline, for each discount point charged by a lender, add  $\frac{1}{8}$  to the stated (contract) mortgage interest rate to estimate the lender's real return (and cost to the borrower) from the loan.

To determine the actual cost to the borrower, in dollars, added by discount points, **each discount point is equal to 1% of the mortgage balance (1 point = 1%)**. The mortgage balance (loan amount) is multiplied by this discount percent to find the dollar amount of the discount being charged.

If the market rate of interest is  $10\frac{1}{4}\%$  and the Lender's rate of interest is  $9\frac{1}{2}\%$ . The following steps should be used to approximate the discount points required to equal the market rate of interest and determine the amount of discount charged on a \$60,000 mortgage.

Calculate the difference in the two rates:

- Current market rate Stated (contract) interest rate = Difference  $10\frac{1}{4}\%$  less  $9\frac{1}{2}\%$  =  $\frac{3}{4}\%$
- Convert the difference to eighths of a percent.  $\frac{3}{4}\%$  =  $\frac{6}{8}\%$  = 6 eighths
- Convert the eighths into discount points.  $\frac{6}{8}$  = 6 discount points

Calculate the Dollar Amount of the Discount Points:

- Each Discount Point = 1% of the Mortgage amount - 6 points x 1% per point = 6%
- Calculate the discount point cost = \$60,000 loan x 6% = \$3,600 (Cost of the Discount Points)

### Assignment of the Mortgage

Without changing the provisions of a contract, a note may be sold to a third party, such as an investor or another mortgage company. The original mortgagee endorses the note to the third party and executes an assignment of mortgage. The assignee becomes the new owner of the debt and security instrument. When the debt is paid in full (or satisfied), the assignee is required to execute the *satisfaction* (or release) of the security instrument.

### Release of the Mortgage Lien

When all mortgage loan payments have been made, and the note has been paid in full, the borrower will want the public record to show that the debt has been satisfied and that the lender is divested of all rights conveyed under the mortgage. By the provisions of the **defeasance clause** in most mortgage documents, the lender is required to execute a **satisfaction of mortgage** (also known as a *release of mortgage* or *mortgage discharge*) when the note has been fully paid. This document returns to the borrower all interest in the real estate originally conveyed to the lender. **Entering this release in the public record shows that the mortgage lien has been removed from the property.**

If a mortgage has been assigned by a recorded assignment, the release must be executed by the assignee or mortgagee to the grantor. The trustee executes and delivers a release deed, sometimes

called a deed of reconveyance, to the trustor. The release deed conveys the same rights and powers that the trustee was given under the deed of trust. The release deed should be acknowledged and recorded in the public records of the county in which the property is located.

Any mortgagee, or his assigns or agents, who fails to deliver a release to the mortgagor or the grantor of a deed of trust within one month after full payment and satisfaction will be liable to pay the mortgagor or grantor a \$200 penalty. The release also must state the following on its face in bold letters: **For the protection of the owner, this release shall be filed with the recorder or the registrar of titles in whose office the mortgage or deed of trust was filed.** It is then the mortgagee's responsibility to record the release.

### Tax and Insurance Reserves

Many lenders require that borrowers provide a reserve fund to meet future real estate taxes and property insurance premiums. This fund is called an **impound account** or an **escrow account**. When the mortgage or deed of trust loan is made, the borrower **starts the reserve by depositing funds to cover the amount of unpaid real estate taxes**. If a new mortgage insurance policy has just been purchased, the **mortgage insurance premium reserve will be started with the deposit of one-twelfth of the insurance premium liability**. The borrower's monthly loan payments will include PITI: principal, interest, tax, and insurance. Other costs, such as flood insurance or homeowners' association dues (condos), may also be included.

### Illinois law — Lender Escrow Accounts

Illinois prescribes additional guidelines that must be followed by lenders who require escrow accounts for mortgage loans on single-family, owner-occupied residential properties. The **Illinois Mortgage Tax Escrow Account Act at 765 ILCS 915/** provides that except during the first year of the loan, a lender may not require an escrow accumulation of more than 150 percent of the previous year's real estate taxes. Lenders must give borrowers written notice of the act's provisions at closing.

The **Illinois Mortgage Escrow Account Act at 765 ILCS 910/** states that when the principal loan balance has been reduced to 65 percent of its original amount, the borrower may terminate his escrow account. The latter does not apply to loans insured, guaranteed, supplemented, or assisted by the state of Illinois or agencies of the federal government such as FHA and VA.

Borrowers have the right to pledge an interest-bearing deposit in an amount sufficient to cover the entire amount of anticipated future tax bills and insurance premiums instead of establishing an escrow account.

### Flood insurance

The **National Flood Insurance Reform Act of 1994** imposes certain mandatory obligations on lenders and loan servicers to **set aside (escrow) funds for flood insurance on new loans**. The act also applies to any loan still outstanding on September 23, 1994. This means that if a lender or servicer discovers that a secured property is in a flood hazard area, it must notify the borrower. The borrower then has 45 days to purchase flood insurance. If the borrower fails to procure flood insurance, the lender must purchase the insurance on the borrower's behalf. The cost of the insurance may be charged to the borrower.

### Assignment of Rents

If the property involved includes rental units, the borrower may provide for rents to be assigned to the lender in the event of the borrower's default. The assignment may be included in the mortgage or deed of trust, or it may be a separate document. In either case, the assignment should clearly indicate that the borrower intends to assign the rents, not merely pledge them as security for the loan. In title-theory states, lenders are automatically entitled to any rents if the borrower defaults.

### Assuming a Seller's Mortgage

When a person purchases real estate that **is subject to an outstanding mortgage** that does not have a "Due on Sale Clause", the buyer may take the property in one of two ways:

1. The buyer may purchase the property *subject* to the mortgage.
2. The buyer may *assume* the mortgage and agree to pay the debt.

When the property is sold *subject* to the mortgage, the buyer is **not personally obligated** to pay the debt in full (seller is ultimately responsible for the payment of the mortgage). In contrast, a buyer who purchases the property and assumes the seller's debt becomes **personally obligated** for the payment of the entire debt.

The existence of a lien does not prevent the transfer of property; however, when a secured loan is assumed, the mortgagee or beneficiary must approve the assumption and any release of liability of the original mortgagor or trustor. Because a loan may not be assumed without lender approval, the lending institution would require the assumer to qualify financially, and many lending institutions charge a transfer fee to cover the costs of changing the records. This charge can be paid by either the buyer or the seller.

### Alienation clause

The lender may want to prevent a future purchaser of the property from being able to assume the loan, particularly if the original interest rate is low. For this reason, some lenders include an **alienation clause**, also known as a **due-on-sale clause** in the note. An alienation clause provides that when the property is sold, the lender may either **declare the entire debt due immediately or allow the mortgage to be assumed**.

### Recording a Mortgage or Deed of Trust

The mortgage document must be recorded in the recorder's office of the county in which the real estate is located. Recording gives constructive notice to the world of the borrower's obligations. Recording also establishes the lien's priority.

### Priority of a Mortgage

**Priority** of mortgages and other liens normally is **determined by the order in which they were recorded**. A mortgage or deed of trust on land that has no prior mortgage lien is a **first mortgage** or *deed of trust*. If the owner later executes **another loan** for additional funds, the new loan becomes a **second mortgage** or *deed of trust* (or a **junior lien**) when it is recorded. The second lien is *subject* to the first lien; **the first has prior claim to the value of the land pledged as security**. Because second loans represent greater risk to the lender, they are usually issued at higher interest rates.

## Subordination Agreement

The priority of mortgage or deed of trust liens may be changed by a *subordination agreement*, in which the first lender *subordinates* its lien to that of the second lender. To be valid, such an agreement must be signed by both lenders.

## OWNER FINANCING

Real estate can be purchased under a land contract, also known as a contract for deed or an **installment contract**. Real estate is usually sold on contract for specific financial reasons. For instance, mortgage financing may be unavailable to a borrower for some reason. High-interest rates may make borrowing too expensive, or the purchaser may not have sufficient down payment to cover the difference between a mortgage loan and the selling price.

Under a land contract, the buyer (called the *vendee*) agrees to make a down payment and a monthly loan payment that includes interest and principal directly to the seller. The payment also may include real estate tax and insurance reserves.

In an **Installment Contract**, the seller (called the *vendor*) retains legal title to the property during the contract term, and the buyer is granted *equitable title* and possession. At the end of the loan term, the seller delivers a clear title. In the event the seller fails to deliver a clear title, the buyer (vendee) would file a vendee's lien. The contract usually permits the seller to evict the buyer in the event of default (instead of going through a foreclosure process). In that case, the seller may keep any money the buyer has already paid. If, however, the buyer has 20 percent equity in the property and a contract in excess of five years, judicial foreclosure would be necessary.

## Foreclosure

**Foreclosure** is a legal procedure in which property pledged as security is sold to satisfy the debt. The foreclosure procedure brings the rights of the parties and all junior lienholders to a conclusion. It passes title either to the person holding the mortgage document or deed of trust or to a third party who purchases the realty at a *foreclosure sale*. The purchaser could be the mortgagee. At the foreclosure sale, the property is sold free of the foreclosing mortgage and all junior liens.

## Methods of Foreclosure

There are three general types of foreclosure proceedings non-judicial, judicial, and strict foreclosure. One, two, or all three may be available. The specific provisions and procedures for each vary from state to state.

- **Non-judicial foreclosure** Some states allow **non-judicial foreclosure** procedures to be used when the security instrument contains a *power-of-sale* clause. In a non-judicial foreclosure, no court action is required.
- **Judicial foreclosure** allows the property to be sold by court order after the mortgagee has given sufficient public notice. When a borrower defaults, the lender may **accelerate the due date of the remaining principal balance**, along with all overdue interest, penalties, and administrative costs. The lender's attorney then can file a suit to foreclose the lien. After the presentation of the facts in court, the property is ordered sold. A public sale is advertised and held, and the real estate is sold to the highest bidder.

- **Strict foreclosure** Although judicial foreclosure is the prevalent practice, it is still possible in some states for a lender to acquire mortgaged property through a **strict foreclosure** process. First, appropriate notice must be given to the delinquent borrower. Second, once the proper papers have been prepared and recorded, the court establishes a deadline by which time the balance of the defaulted debt must be paid in full. If the borrower does not pay off the loan by that date, the court simply awards the full legal title to the lender. No sale takes place.

By Illinois statute, mortgage foreclosures may be brought about only through a court proceeding. As a result, Illinois is classified as a judicial foreclosure state. Under the **Illinois 1987 Mortgage Foreclosure Law**, the term mortgage includes:

- deeds of trust,
- installment contracts payable over a period in excess of five years (when the unpaid balance is less than 80 percent of the purchase price),
- certain collateral assignments of the beneficial interest in land trusts used as security for lenders, and
- traditional mortgage instruments.

### **Deed in Lieu of Foreclosure**

As an alternative to foreclosure, a lender may accept a **deed in lieu of foreclosure** from the borrower. This is sometimes known as a **friendly foreclosure** because it is carried out by mutual agreement rather than by a lawsuit. The major disadvantage of the "deed in lieu" is that the mortgagee takes the real estate subject to all junior liens. In a foreclosure action, all junior liens are eliminated. Also, by accepting a deed in lieu of foreclosure, the lender usually loses any rights pertaining to FHA or private mortgage insurance or VA guarantees. Usually, a deed in lieu of foreclosure has a negative effect on the owner's credit rating.

### **Short Sales**

A **short sale** is a process by which a lender accepts less than the amount owed on the property. The lender agrees to accept less because the lender may lose more money by acquiring the property through a foreclosure process and then holding the property until the lender can find another buyer.

An owner who wants the lender to accept a short sale must qualify for the procedure:

1. The owner must owe more on the property than the current value.
2. The owner must have a hardship such as a medical emergency, family death, divorce, etc.
3. The owner must have a reduction in income such as loss of their job.

The seller can list their property with a real estate company, but the lender must approve the final sales price if less than what is owed.

If there is more than one mortgage on the property, the first lienholder must notify the other lien holders before the settlement of the short sale. There is a very good chance that the second or third lien holders will receive nothing on a short sale. Many buyers seek to purchase a short sale because they often sell for less than market value.

The process of a short sale can take several months and often doesn't close. The buyer must be aware that there may be years of deferred maintenance on the property, and it can cost much more money in the long run compared to a property that was not in distress. Licensed real estate agents must be sure that the individual(s) going through a short sale process seek the advice of legal counsel.

Lenders typically reserve the right to file suit to acquire the missing amount, called a **deficiency**. Although few lenders actually file suit to recover the missing amount, they can. Because the borrower has received the money and has not repaid it, the borrower generally owes income tax on the deficient amount (i.e., the amount forgiven in the short sale and then receiving an **IRS Form 1099**). Under the **Mortgage Debt Relief Act of 2007**, however, taxpayers are permitted to exclude from taxable income the amount of debt reduced through mortgage restructuring as well as mortgage debt forgiven through foreclosure. The act applies to debt forgiven in the years 2007 through 2012. For specific details, be sure to consult a competent accountant.

## GOVERNMENT ASSISTANCE PROGRAMS – FORECLOSURES

### **HAMP-Home Affordable Modification Program**

The goal of **HAMP** is to help delinquent borrowers modify the terms of their home mortgage loan to an affordable level (i.e., **no more than 31 percent of the borrower's pretax monthly income** using a combination of three factors:

- reduce the interest rate,
- increase the term up to 40 years,
- reduce the principal on which interest is charged.

Modifications are only available to owner-occupants of one to four-family dwellings with loan amounts not exceeding \$729,750 for a single-family dwelling (amounts increase for 2, 3, or 4 units). HAMP is a voluntary program.

### **HAFA-Home Affordable Foreclosure Alternatives**

The HAFA program provides alternatives to foreclosures by encouraging lenders and delinquent borrowers to enter into a **short sale or a deed-in-lieu of foreclosure**.

### **Redemption**

Most states give defaulting borrowers a chance to redeem their property through the **equitable right of redemption**. Some states also allow defaulted borrowers a period in which to redeem their real estate **after the sale**.

There is no statutory right of redemption in Illinois. In Illinois, a mortgagor in default who wishes to exercise the equitable right of redemption to avoid loss of the mortgaged real estate may do so for a period of seven months after the date of service on the mortgagor or after first publication date, whichever is later. This time period can currently be shortened to as little as **30 days** after a judgment is entered if the **property has been abandoned or is vacant**. When a property is redeemed in this way, the foreclosure sale does not occur. Otherwise, the foreclosure sale is held as soon as possible after the equitable right of redemption expires.



The mortgagor generally has a right to remain in possession of the property from the time of service of the summons until the entry of a judgment of foreclosure. After judgment and through the 30th day after confirmation of the sale, the mortgagor can still retain possession, but (s)he may be required to pay rent to the holder of the certificate of sale. Thirty-one days after judgment, the mortgagor must have vacated the property or be subject to eviction. The owner of the certificate of sale receives a **sheriff's deed** and gains the right to possession.

While Illinois does not have a statutory right of redemption, it does offer a **statutory right of reinstatement**. This option is applicable when the defaulting mortgagor **wishes to cure the default and reinstate the loan as if no acceleration had occurred**. The mortgagor has the right to exercise this statutory right for a period of **90 days after the service** of summons or publication date. At the lender's discretion, expressed through an attorney, the right of reinstatement may be extended to run as long as the equitable right of redemption.

The reinstatement right usually may be exercised only **once every five years**. After reinstatement occurs, the suit must be dismissed by the lender, and the mortgage loan remains in effect just as before. (See the **Illinois Code of Civil Procedure, Article 15; 735 ILCS 51**).

When a default is not cured by redemption or reinstatement, the entry of a decree of foreclosure will lead to a **judicial sale** of the property, usually called a **sheriff's sale**. Each defendant to the suit must be given **written personal notice of the sale**, and public notice of the sale must be published in a newspaper of general circulation. The successful bidder at the sale receives a **certificate of sale**, not a deed. **Only after the sale is confirmed by the court will the certificate holder receive a sheriff's deed.**

### **Deficiency Judgment**

The foreclosure sale may not produce enough cash to pay the loan balance in full after deducting expenses and accrued unpaid interest. In this case, where permitted by law, the mortgagee may be entitled to a personal judgment against the borrower for the unpaid balance. Such a judgment is a **deficiency judgment**. However, if any money remains from the foreclosure sale after paying the debt and any other liens (such as a second mortgage or mechanic's lien), expenses, and interest, these proceeds are paid to the borrower.

## **THE REAL ESTATE FINANCING MARKET**

### **The Federal Reserve System**

The role of the Federal Reserve System (the Fed) is to maintain sound credit conditions, help counteract inflationary and deflationary trends, and create a favorable economic climate.

- The Fed divides the country into **12 federal reserve districts**, each served by a federal reserve bank.
- All nationally chartered banks **must join the Fed**
- All nationally chartered banks **must purchase stock in its district reserve banks**.

The Federal Reserve System regulates the flow of money and interest rates in the marketplace through its member banks by controlling *reserve requirements* and *discount rates*.

## Reserve requirements

The Federal Reserve System requires that each member bank keep a **certain level of assets on hand as reserve funds**. These reserves are unavailable for loans or any other use. This requirement not only protects customer deposits but also provides a means of manipulating the flow of cash in the money market. The amount of money a bank can loan is tied to this reserve amount.

## Fed Controls

**Decreasing** reserve requirements lowers rates - **Increases** money for loans

**Increasing** reserve requirements raises rates - **Decreases** money for loans

By increasing its reserve requirements, the Federal Reserve System, in effect, limits the amount of money that member banks can use to make loans. When the amount of money available for lending decreases, interest rates (the amount lenders charge for the use of their money) rise. By causing interest rates to rise, the Fed can slow down an overactive economy; higher rates limit the number of loans that would have been directed toward major purchases of goods and services. The opposite is also true: By decreasing the reserve requirements, the Fed can encourage more lending. Increased lending causes the amount of money circulated in the marketplace to rise while simultaneously causing interest rates to drop.

## Discount rate

Federal Reserve member banks are permitted to **borrow money from the district reserve banks to expand their lending operations (increase reserves)**. The discount rate is the rate charged by the Federal Reserve when it lends money to its member banks.

The **prime rate (the short-term interest rate charged to a bank's largest, most creditworthy customers)** is strongly influenced by the Fed's discount rate. In turn, the prime rate is often the basis for **determining a bank's interest rate on other loans, including home mortgages**.

When the Federal Reserve System **discount rate is high, bank interest rates are high**. When bank interest rates are high, fewer loans are made, and less money circulates in the marketplace. A **lower discount rate results in lower interest rates**, more bank loans, and more money in circulation.

## The Primary Mortgage Market

The primary mortgage market is made up of the **lenders that originate mortgage loans**. These lenders make money available directly to borrowers. From a borrower's point of view, a loan is a means of financing an expenditure; from a lender's point of view, a loan is an investment. All investors look for profitable returns on their investments. Income on the loan is realized from two sources:

- Finance charges collected at closing, such as loan origination fees and discount points
- Recurring income the interest collected during the term of the loan

In addition to the income directly related to loans, some lenders derive income from servicing loans for other mortgage lenders or the investors who have purchased the loans. Servicing loans involves such activities as:

- collecting payments (including insurance and taxes),
- accounting,

- bookkeeping,
- preparing insurance and tax records,
- processing payments of taxes and insurance, and
- following up on loan payment and delinquency.

### Primary Mortgage Market

- Thrifts
- Savings associations
- Commercial banks
- Insurance companies
- Credit unions
- Pension funds
- Endowment funds
- Investment group financing
- Mortgage banking companies

### Mortgage Broker Licensing

The federal **Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act)** requires that each individual state must license and register mortgage loan originators (MLOs).

An MLO is defined as **anyone who, for compensation or expectation of compensation, takes a residential mortgage loan by phone or in person.** Among those exempt from license requirements are those who perform only clerical or administrative tasks and real estate licensees unless compensated by a loan originator. Because Illinois is a participant, all Illinois MLOs are required to register. Illinois also requires an eight-hour continuing education course.

### The Secondary Mortgage Market

In the secondary mortgage market, **loans are bought and sold only after they have been funded by primary lenders. Lenders routinely sell loans to increase reserves, avoid interest rate risks, and to realize profits on the sales.** This secondary market activity helps lenders raise capital to continue making mortgage loans. Secondary market activity is especially desirable when money is in short supply; it stimulates both the housing construction market and the mortgage market by expanding the types of loans available.

When a loan is sold, the original lender may continue to collect the payments from the borrower. The lender then passes the payments along to the investor who purchased the loan. The investor is charged a fee for servicing of the loan.

In the secondary market, various agencies purchase a number of mortgage loans and assemble them into packages (called pools). These agencies purchase mortgages from banks and savings associations. **Securities that represent shares in these pooled mortgages are then sold to investors or other agencies and the public.**

Institution	Secondary Market Function
Fannie Mae	Conventional, VA, FHA Loans
Freddie Mac	Mostly conventional loans
Ginnie Mae	Special assistance loans

### Fannie Mae

In September 2008, the **Federal National Mortgage Association (Fannie Mae)** became a **government-owned enterprise**. Until that time, it was organized as a completely privately owned corporation that issued its own stock.

Then, as now, it provides a secondary market for mortgage loans. Fannie Mae deals in conventional and Federal Housing Administration (FHA) and Department of Veterans Affairs (VA) loans. Fannie Mae buys from a lender a block or pool of mortgages that may then be used as collateral for mortgage-backed securities that are sold on the global market.

### Freddie Mac

The **Federal Home Loan Mortgage Corporation (Freddie Mac)** is also now a government-owned enterprise, similar to Fannie Mae, which provides a secondary market primarily for conventional loans.

Many lenders use the standardized forms and follow the guidelines issued by Fannie Mae and Freddie Mac. In fact, the use of such forms is mandatory for lenders wishing to sell mortgages in the agencies' secondary mortgage market. The standardized documents include loan applications, credit reports, and appraisal forms.

### Ginnie Mae

The **Government National Mortgage Association (Ginnie Mae)** has always been a governmental agency. Ginnie Mae is a division of the Department of Housing and Urban Development (HUD), organized as a corporation without capital stock. Ginnie Mae guarantees mortgage-backed securities using FHA and VA loans as collateral.

The **Ginnie Mae pass-through certificate** is a security interest in a pool of mortgages that provides for a monthly pass-through of principal and interest payments directly to the certificate holder. Such certificates are guaranteed by Ginnie Mae.

## FINANCING TECHNIQUES

### Straight Loans

A **straight loan** or **interest-only loan** (also known as a **term loan**) is a **non-amortized loan** that essentially divides the loan into two amounts to be paid off separately. The borrower makes **periodic payments of interest only**, followed by the **payment of the principal in full at the end of the term.**

### Amortized Loans

Unlike a straight loan payment, the payment in an **amortized loan partially pays off both principal and interest.** Most mortgage and deed of trust loans are amortized loans. Regular periodic payments

are made over a term of years, generally 15 or 30 years, although 40- and 50-year mortgages are available. Each payment is applied first to the interest owed; the balance of the payment is then applied to the principal amount.

### Interest and Principal Credited from Amortized Payments

Lenders charge borrowers a certain percentage of the principal as interest for each year a debt is outstanding. The amount of interest due on any one payment date is calculated by computing the total yearly interest (based on the unpaid balance) and dividing that figure by the number of payments made each year.

For example, assume the current outstanding balance of a loan is \$70,000. The interest rate is 7.5 percent per year, and the monthly payment is \$489.30. Based on these facts, the interest and principal due on the next payment would be computed as shown:

**\$70,000 loan balance x .075 annual interest rate = \$5,250 annual interest**

**\$5,250 annual interest 12 months = \$437.50 monthly interest**

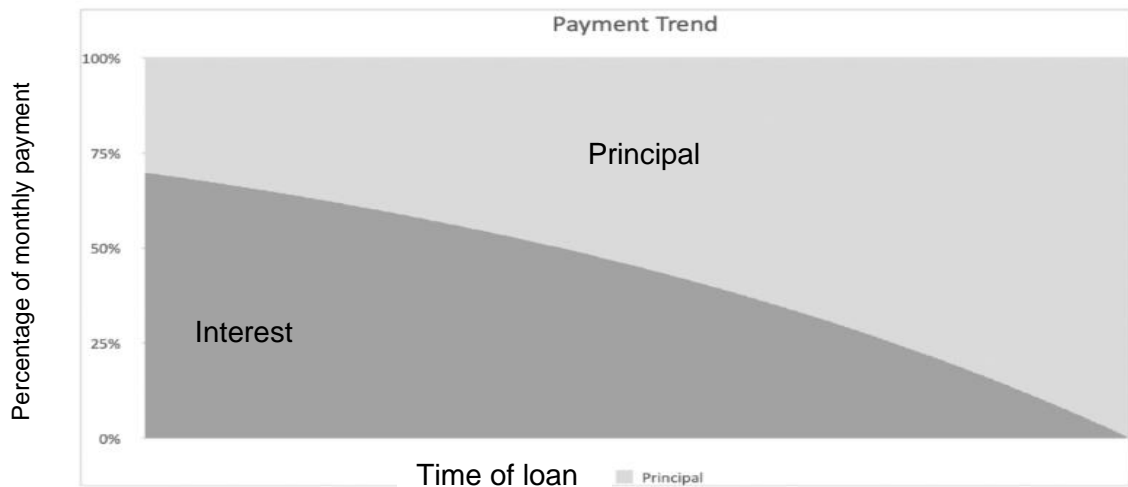
**\$489.30 monthly payment— \$437.50 monthly interest = \$51.80 monthly principal**

**\$70,000 loan balance — \$51.80 monthly principal = \$69,948.20**

**This process is followed with each payment over the term of the loan. The same calculations are made each month, starting with the declining new balance figure from the previous month.**

The most frequently used plan is the **fully amortized loan**, or **level-payment loan**. The mortgagor **pays a constant amount, usually monthly**. The lender credits each payment **first to the interest due**, then **to the principal amount of the loan**. As a result, while each payment remains the **same**, the portion applied to repayment of the **principal grows** and the **interest due declines** as the unpaid balance of the loan is reduced. If the borrower pays additional amounts that are applied directly to the principal, the loan will amortize more quickly. This benefits the borrower because (s)he will pay less interest if the loan is paid off before the end of its term.

### Level-Payment Amortized Loan



**Monthly Payments Required  
To Repay a \$1,000 loan**

%	NO. OF YEARS							
	5	10	15	20	25	30	35	40
6	19.33	11.10	8.44	7.16	6.44	6.00	5.70	5.50
6 ¼	19.45	11.23	8.57	7.31	6.60	6.16	5.87	5.68
6 ½	19.57	11.35	8.71	7.46	6.75	6.32	6.04	5.85
6 ¾	19.68	11.48	8.85	7.60	6.91	6.49	6.21	6.03
7	19.80	11.61	8.99	7.75	7.07	6.65	6.39	6.21
7 ¼	19.92	11.74	9.13	7.90	7.23	6.82	6.56	6.40
7 ½	20.04	11.87	9.27	8.06	7.39	6.99	6.74	6.58
7 ¾	20.16	12.00	9.41	8.21	7.55	7.16	6.92	6.77
8	20.28	12.13	9.56	8.36	7.72	7.34	7.10	6.95
8 ¼	20.40	12.27	9.70	8.52	7.88	7.51	7.28	7.14
8 ½	20.52	12.40	9.85	8.68	8.06	7.69	7.47	7.34
8 ¾	20.64	12.54	10.00	8.84	8.23	7.87	7.66	7.53
9	20.76	12.67	10.15	9.00	8.40	8.05	7.84	7.72
9 ¼	20.88	12.81	10.30	9.16	8.57	8.23	8.03	7.91
9 ½	21.01	12.94	10.45	9.33	8.74	8.41	8.22	8.11
9 ¾	21.13	13.08	10.60	9.49	8.92	8.60	8.41	8.30
10	21.25	13.22	10.75	9.66	9.09	8.78	8.60	8.50
10 ¼	21.38	13.36	10.90	9.82	9.27	8.97	8.79	8.69
10 ½	21.50	13.50	11.06	9.99	9.45	9.15	8.99	8.89
10 ¾	21.62	13.64	11.21	10.16	9.63	9.34	9.18	9.09
11	21.75	13.78	11.37	10.33	9.81	9.53	9.37	9.29
11 ¼	21.87	13.92	11.53	10.50	9.99	9.72	9.57	9.49
11 ½	22.00	14.06	11.69	10.67	10.17	9.91	9.77	9.69
11 ¾	22.12	14.21	11.85	10.84	10.35	10.10	9.96	9.89
12	22.25	14.35	12.01	11.02	10.54	10.29	10.16	10.09
12 ¼	22.38	14.50	12.17	11.19	10.72	10.48	10.36	10.29
12 ½	22.50	14.64	12.33	11.37	10.91	10.66	10.56	10.49
12 ¾	22.63	14.79	12.49	11.54	11.10	10.87	10.76	10.70
13	22.76	14.94	12.66	11.72	11.28	11.07	10.96	10.90

How much money would a buyer have to pay extra per month on a \$150,000 loan at 7% on a 15-year mortgage, versus a \$150,000 loan at 7½% on a 30-year mortgage?

Using the chart, 7% at 15 years is \$8.99 per month, 7½% at 30 years is \$6.99 per month. So, \$8.99 minus \$6.99 equals \$2.00 per month (per thousand). If the loan is \$150,000, then 150 times \$2.00 equals \$300 per month. So, the buyer would have to pay an extra \$300 per month to have the property paid off in 15 years instead of 30 years.

### Adjustable-Rate Mortgages (ARMs)

Adjustable-rate mortgages (ARMs) generally **originate at one rate of interest**, then **fluctuate up or down** during the loan term, based on some objective economic indicator. Because the interest rate on ARMs may change, the mortgagor's **loan repayments also may change**. Common components of an ARM include the following:

- The index is an undeterminable economic indicator that is used to adjust the interest rate in the loan. Most indexes are tied to U.S. Treasury securities.
- Usually, the interest rate is the index rate plus a premium, called the *margin*. The margin represents the lender's cost of doing business.
- *Rate caps* limit the amount the interest rate may change. Most ARMs have two types of rate caps periodic and aggregate. A *periodic rate cap* limits the amount the rate may increase at any one time. An *aggregate rate cap* limits the amount the rate may increase over the entire life of the loan.
- The mortgagor is protected from unaffordable individual payments by the payment cap. The payment cap sets a maximum amount for payments.
- The adjustment period establishes how often the rate may be changed, whether it is monthly, quarterly, or annually.
- Lenders may offer a conversion option, which permits the mortgagor to convert from an adjustable-rate to a fixed-rate loan at certain intervals during the life of the mortgage.

### Balloon Payment Loan

When the **periodic payments are not enough to fully amortize the loan by the time the final payment is due**, the **final payment is larger than the others in order to pay off the full loan**. This is called a balloon payment. A balloon loan is a partially *amortized* loan because the principal is still owed at the end of the term.

### Growing-Equity Mortgage (GEM)

A growing equity mortgage (GEM) is also known as a *rapid-payoff or graduated-payment mortgage*. The GEM uses a **fixed interest rate**, but **payments of principal are increased according to an index or a schedule**. Thus, the total payment increases and the loan is paid off more quickly. A GEM is most frequently used when the borrower's income is expected to keep pace with the increasing loan payments.

### Reverse Mortgage

A reverse mortgage allows **people 62 or older to borrow money against the equity** they have built in their home. The money may be used for any purpose, and the borrowers decide if they want to receive the money in a lump sum, fixed monthly payments, an open line of credit, or other options.

The borrower is charged a **fixed rate of interest**, and **no payments are due until the property is sold or the borrower defaults, moves, or dies**. Though reverse mortgages have been available for almost 30 years, they have become more widespread as people live longer and need more money. The **FHA home equity conversion mortgage (HECM)** is one of the more common reverse mortgages.

## Nonrecourse Loan

A *nonrecourse loan* is one in which the **borrower is not held personally responsible for the loan**. The lender has no recourse against the borrower personally in the event of a default. Nonrecourse loans are common in those situations in which the lender is highly confident that the **value of the property involved is itself sufficient security**. Nonrecourse loans are more common in **commercial and investment real estate** transactions than in residential situations.

## LOAN PROGRAMS

### Conventional Loans

**Conventional loans** are viewed as **the most secure loans** because their **loan-to-value ratios are often lowest**. Usually, the ratio is 80 percent of the value of the property or less because the **borrower makes a down payment of at least 20 percent**. The security for the loan is provided solely by the mortgage; the payment of the debt rests on the ability of the borrower to pay. In making such a loan, the lender relies primarily on its appraisal of the property. Information from credit reports that indicates the reliability of the prospective borrower is also important. No additional insurance or guarantee on the loan is necessary to protect the lender's interest. In conventional loans, the government is not involved.

Lenders can set criteria by which a borrower and the collateral are evaluated to qualify for a loan. Today, the secondary mortgage market has a significant impact on borrower qualifications, standards for the collateral, and documentation procedures followed by lenders. Loans must meet strict criteria to be sold to Fannie Mae and Freddie Mac. Lenders still can be flexible in their lending decisions, but they may not be able to sell unusual loans in the secondary market.

### DETERMINING LTV

If a property has an appraised value of \$100,000, secured by a \$90,000 loan, the LTV is 90 percent:  
 $\$90,000/\$100,000 = 90\%$

Low LTV	High LTV
High Down Payment Small Loan	Low Down Payment Large Loan

### Importance of credit scores

The creditworthiness of buyers also is a key element in qualifying for a conventional loan today. Underwriters consider several factors known about the applicant before determining whether to make the loan (e.g., credit scores and payment history). Today, with the exception of FHA loans and a few non-conforming loans, the interest rate available to borrowers is largely **based on credit scores, which can range from 300 to 850**. The higher the credit score, the lower the risk to the lender. Lenders offer these borrowers lower interest rates and may permit a smaller down payment. Lenders almost always require a higher interest rate and/or a larger down payment for those with lower scores. Today, the FHA is the best source for a mortgage loan for a borrower with a lower credit score.

The **nonconforming market** accepts loans that **do not meet Fannie Mae and Freddie Mac requirements**. Examples of such loans include loan amounts that exceed the limits set by Fannie Mae and Freddie Mac, loans secured by a property that does not qualify (e.g., commercial, more than four



family units), and factors specific to the individual borrower (e.g., no down payment, high debt-to-income ratios, or the self-employed borrower does not show enough income to qualify).

### Importance of credit history

In addition to credit scores, underwriters consider **two years in detail and up to seven years of repayment history**, whether or not the applicant has made timely payments, especially for rent and/or mortgage loans. A payment is considered late if more than 30 days past due. Underwriters especially look for bankruptcies, judgments, and foreclosures. Applicants who are consistently **more than 30 days late for rent or mortgage payments** will most likely be **ineligible for VA and FHA loans and others that are sold to Fannie Mae and Freddie Mac**.

### Judgments, foreclosures, bankruptcies

Fannie Mae, Freddie Mac, FHA, and the VA **require that all judgments be paid in full**, and they prefer that the judgments be at least two years old. Generally, the nonconforming market is open to funding and buying loans, even if the judgment has not been paid so long as the judgment does not impact the title.

For most **bankruptcy actions**, both Fannie Mae and Freddie Mac require **four years to re-establish credit**. Fannie Mae and Freddie Mac may purchase loans made to someone who was in foreclosure. However, they require that the **foreclosure of the borrower's primary residence be at least three years prior** and caused by **circumstances out of the borrower's control, such as the death of the primary wage earner, job layoff, or serious long-term illness**. Although the nonconforming market may purchase a loan, it often requires a substantial down payment if the foreclosure is less than three years old.

### Financial Qualifications

To qualify for a conventional loan under Fannie Mae guidelines,

- the borrower's monthly housing expenses, including PITI, **must not exceed 28 percent of total monthly gross income**.
- the borrower's total monthly obligations, including housing costs plus other regular monthly payments, **must not exceed 36 percent of the total monthly gross income** (33 percent in the case of 95 percent LTV loans).

**Loans that meet these criteria are called *conforming loans* and are eligible to be sold in the secondary market.** Loans that exceed the limits are referred to as *non-conforming loans* and are not marketable in the secondary market but, instead, are generally held in the lender's investment portfolio.

Conforming loans with larger ratios may be available in certain situations. Both Fannie Mae and Freddie Mac currently have a variety of conforming affordable loan products with qualifying ratios of 33 percent for housing expense and up to 38 percent for total debt. These loans only require a 3 percent down payment but are subject to certain income limitations and may require the borrowers to attend homeownership classes.

## Private Mortgage Insurance

One way a borrower can obtain a mortgage loan with a lower down payment is by obtaining **private mortgage insurance (PMI)**. In a PMI program, the borrower purchases an insurance policy that provides the lender with funds in the event the borrower defaults on the loan. This allows the lender to assume more risk so that the loan-to-value ratio is higher than for other conventional loans. The borrower purchases insurance from a private mortgage insurance company as additional security to insure the lender against borrower default.

**PMI protects the top 20 to 30 percent of the loan against borrower default.** The borrower pays a monthly fee, which can be financed in with the loan, while the insurance is in force. Because only a portion of the loan is insured, **the lender must allow the borrower to terminate the coverage once the loan is repaid to a certain level.**

Under the **Homeowners' Protection Act of 1998** (implemented in 1999), **PMI must terminate automatically when the borrower reaches a 22 percent equity position based on the original value of the property at the time the loan was originated** with **no allowance for appreciation or depreciation** if the loan was written **after July 29, 1999**, and the borrower is current on mortgage payments.

## FHA-Insured Loans

The **Federal Housing Administration (FHA)**, which operates under HUD, neither builds homes nor lends money. The common term **FHA loan** refers to a loan that is **insured by** the agency. These loans must be made by FHA-approved lending institutions. The FHA insurance **provides security to the lender in addition to the real estate. As with private mortgage insurance, the FHA insures lenders against loss from borrower default.**

Certain technical requirements must be met before the FHA will insure the loans. These requirements include the following:

- The borrower must pay a down payment of at least 3.5 percent of the purchase price, but most of the closing costs and fees can be included in the loan.
- The borrower is charged a mortgage insurance premium (MIP) for all FHA loans. The up-front *premium* is charged at closing and can be financed into the mortgage loan. The borrower is also responsible for paying an annual premium that is usually charged monthly. The up-front premium is charged on all FHA loans, except those for the purchase of a condominium, that require only a monthly MIP.
- The mortgaged real estate must be appraised by an approved FHA appraiser. The FHA sets maximum mortgage limits for various regions of the country.
- The borrower must meet standard FHA credit qualifications.
- Financing for manufactured homes and factory-built housing is also available, both for those who own the land that the home is on and also for manufactured homes that are, or will be, located on another plot of land.

### FHA 203(b) Loan

The FHA 203(b) loan insurance program is for people who want a single-family FHA insured mortgage loan. The FHA 203(b) may be used to purchase or refinance a new or existing one-to-four family owner occupied property in both urban and rural areas.

### FHA 203(k) Loan

An FHA 203(k) loan combines 2 loans into one loan - one to purchase a property and one to renovate or repair. A renovation loan allows the home purchaser a loan to renovate and remodel their new purchase.

If the purchase price exceeds the FHA-appraised value, the buyer may pay the difference in cash as part of the down payment. Some exceptions are made for special programs, such as the **Good Neighbor Program**.

Other types of FHA loans are available, including:

- one-year adjustable-rate mortgages,
- home improvement and rehabilitation loans,
- loans for the purchase of condominiums.

Specific standards for condominium complexes and the ratio of owner-occupants to renters must be met for a loan on a condominium unit to be financed through the FHA insurance programs.

**A qualified buyer may assume an existing FHA-insured loan.** The application consists of a credit check to demonstrate that the person assuming the loan is financially qualified. The process is quicker and less expensive than applying for a new loan. Sometimes, the older loan has a lower interest rate, and no appraisal is required.

### FHA Assumption rules

The assumption rules for FHA-insured loans vary, depending on the dates the loans were originated, as follows: For FHA loans originating on December 15, 1989, and later, no assumptions are permitted without complete buyer qualification.

### Discount points

The lender of an FHA-insured loan **may charge discount points in addition to a loan origination fee**. The payment of points is a matter of negotiation between the seller and the buyer. As of November 2009, if **the seller pays more than 6 percent of the costs normally paid by the buyer** (such as discount points, the loan origination fee, the mortgage insurance premium, buy-down fees, prepaid items, and impound or escrow amounts), **the lender will treat the payments as a reduction in sales price and recalculate the mortgage amount accordingly**.

### VA-Guaranteed Loans

The Department of Veterans Affairs (VA) is authorized to **guarantee loans** to purchase or construct homes for eligible veterans and their spouses (including un-remarried spouses of veterans whose deaths were service-related).

Eligibility is defined as veterans who:

- served on active duty
- have some form of honorable discharge after a minimum of 90 days of service during wartime and a minimum of 181 continuous days in times of peace.
- Two years are required for veterans who enlisted and began service after September 7, 1980, or for officers who began service after October 16, 1981.
- Six years are required for reservists and members of the National Guard.
- There are specific rules regarding the eligibility of surviving spouses.

With over 25.5 million veterans and service personnel eligible, a VA loan is desirable and has many benefits. The VA assists veterans in financing the purchase of homes with **little or no down payments** at market interest rates. The VA issues rules and regulations that set forth the qualifications, limitations, and conditions under which a loan may be guaranteed.

Like the FHA loan, VA *loan* is something of a misnomer. **The VA does not normally lend money; it guarantees loans made by lending institutions approved by the agency.** The term VA *loan* refers to a loan that is not made by the agency but is guaranteed by it.

There is **no VA dollar limit on the amount of the loan a veteran can obtain**; this limit is determined by the lender and qualification of the buyer. **The VA limits the amount of the loan it will guarantee.**

### In Practice

The VA loan guarantee is tied to the current conforming loan limit for Fannie Mae and Freddie Mac. Typically, lenders will loan four times the guarantee (for example, a conforming loan of \$417,000 ÷ 4 = \$104,250 VA guarantee).

To **determine what portion of a mortgage loan the VA will guarantee**, the veteran must apply for a **certificate of eligibility**. This certificate does not mean that the veteran automatically receives a mortgage. It merely sets forth the maximum guarantee to which the veteran is entitled. For individuals with full eligibility, no down payment is required for a loan up to the maximum guaranteed limit.

The VA also issues a **certificate of reasonable value (CRV)** for the property being purchased. The CRV states the property's **current market value based on a VA-approved appraisal**. The CRV places a ceiling on the amount of a VA loan allowed for the property. If the purchase price is greater than the amount cited in the CRV, the veteran may pay the difference in cash. The CRV is based on an appraisal. New VA regulations allow **only one active VA loan at a time**, and a **veteran may own only two properties that were acquired using VA loan benefits**. **VA benefits will never expire as long as the previous benefit use has been paid.**

The VA borrower pays a **loan origination fee to the lender**, as well as a **funding fee to the Department of Veterans Affairs**. The funding fee depends on whether it is first-time use (2.15 percent) or a subsequent use (3.15 percent). The funding fee drops with down payments of 5 percent or more. Reservists and National Guard veterans pay higher funding fees. Reasonable discount points may be charged on a VA-guaranteed loan, and either the veteran or the seller may pay them.

### VA Prepayment privileges

As with an FHA loan, the borrower under a VA loan can prepay the debt at any time without penalty.

### Assumption rules

March 1, 1988, the **VA must approve the buyer and assumption agreement**. The original veteran borrower remains personally liable for the repayment of the loan unless the VA approves a *release of liability*. The release of liability will be issued by the VA only if:

- the buyer assumes all of the veteran's liabilities on the loan,
- the VA or the lender approves both the buyer and the assumption agreement.

Releases are also possible if veterans use their own entitlement in assuming another veteran's loan.

### VA legislation

The **Veterans Millennium Health Care and Benefits Act of 1999, Public Law 106-117**, authorized the VA to restore the home loan eligibility of surviving spouses who lost such eligibility as a result of remarriage if the remarriage has been terminated by death or divorce.

### Agricultural Loan Programs

The **Farm Service Agency (FSA)** is a federal agency of the Department of Agriculture. The FSA offers programs to help families purchase or operate family farms.

Through the Rural Housing and Community Development Service (RHCDs), it also provides loans to help families purchase or improve single-family homes in rural areas. FSA loan programs fall into two categories: guaranteed loans, made and serviced by private lenders and guaranteed for a specific percentage by the FSA, and loans made directly by the FSA.

The **Farm Credit System (Farm Credit)** provides loans to farmers, ranchers, rural homeowners, agricultural cooperatives, rural utility systems, and agribusinesses. Unlike commercial banks, Farm Credit System banks and associations do not take deposits. Instead, loanable funds are raised through the system-wide sale of bonds and notes in the nation's capital markets.

**Farmer Mac (formerly the Federal Agricultural Mortgage Corporation, or FAMC)** is another government-sponsored enterprise (GSE) that operates similarly to Fannie Mae and Freddie Mac but in the context of agricultural loans. It was created to improve the availability of long-term credit at stable interest rates to America's farmers, ranchers, and rural homeowners, businesses, and communities. Farmer Mac pools or bundles agricultural loans from lenders for sale as mortgage-backed securities.

## OTHER FINANCING TECHNIQUES

### Purchase-Money Mortgages

This is a note and mortgage created at the time of purchase when the **seller agrees to finance all or part of the purchase price and consists of a first or junior lien depending on whether prior mortgage liens exist**. This is based on the fact that **the seller gives the buyer title to the property**. Often referred to as seller financing or owner financing, a PMM is often used when the buyer does not qualify for a typical lender loan. The buyer/borrower executes a note and mortgage at the time of purchase; the seller records

the mortgage against the property. Payments are made to the seller according to the terms of the note. If the buyer stops making payments, the seller has recourse **to foreclose on the property.**

### Package Loans

A **package loan includes real and personal property.** In recent years, these kinds of loans have been **very popular with developers and purchasers** of furnished condominiums. Package loans usually include furniture, drapes, kitchen range, refrigerator, dishwasher, washer, dryer, food freezer, and other appliances as part of the sales price of the home.

### Blanket Loans

A **blanket loan covers more than one parcel or lot.** It is usually used to finance subdivision developments. However, it can be used to finance the purchase of improved properties or to consolidate loans as well. A blanket loan usually includes a provision known as a **partial release clause.** This clause permits the borrower to **obtain the release of any one lot or parcel from the lien by repaying a certain amount of the loan. The lender issues a partial release for each parcel released from the mortgage lien.** The release form includes a provision that the lien will continue to cover all other unreleased lots.

### Wraparound Loans

A **wraparound loan** enables a borrower with an existing mortgage or deed of trust loan to obtain additional financing **from a second lender without paying off the first loan.** The **second lender gives** the borrower a new increased loan at a higher interest rate and **assumes payment of the existing loan.** The total amount of the new loan includes the existing loan as well as the additional loan taken out by the borrower. The borrower makes payments to the new lender based on the total amount, and the new lender, in turn, makes payments on the original loan out of the borrowers' payments.

A wraparound mortgage can be used to refinance a real property or to finance the purchase of a real property **when an existing mortgage cannot be prepaid.** The buyer executes a wraparound mortgage to the seller or lender, who collects payments based on the terms of the new loan and continues to make payments on the old loan.

### Open-End Loans

An **open-end loan** secures a note executed by the borrower to the lender. It also secures any future advances of funds made by the lender to the borrower. The interest rate on the initial amount borrowed is fixed, but interest on future advances may be charged at the market rate in effect. It allows the borrower to "open" the mortgage or deed of trust **to increase the debt to its original amount, or the amount stated in the note after the debt has been reduced by payments over a period of time.** The mortgage usually states a maximum amount that can be secured, the terms and conditions under which the loan can be opened, and the provisions for repayment.

### Construction Loans (Interim Financing)

Construction loans are **generally short-term** or *interim financing*. The borrower **pays interest only** on the monies that have actually been disbursed. The borrower is expected to arrange for a permanent

loan, also known as an **end loan or take-out loan**, which will repay or take out the construction financing lender when the work is completed.

### **Sale-Leaseback**

**Sale-leaseback** arrangements are used to finance large commercial or industrial properties. The land and building, usually used by the seller for business purposes, are sold to an investor. The real estate is then **leased back by the investor to the seller**, who continues to conduct business on the property as a tenant. The buyer becomes the landlord (lessor), and the original owner becomes the tenant (lessee). This enables a business to free **money tied up in real estate to use as working capital or to take advantage of accounting practices in the treatment of leases versus assets (balance sheet reports)**.

### **Buy-downs**

A **buy-down** is a way to **temporarily (or permanently) lower the initial interest rate on a mortgage or deed of trust loan**. Typical buy-down arrangements **reduce the interest rate by 1 to 2 percent over the first one to two years of the loan term**. After that, the rate rises. The assumption is that the borrower's income will also increase, making it more likely that the borrower will be able to pay the increased monthly payments. In a permanent buy-down, a larger up-front payment reduces the effective interest rate for the life of the loan.

### **Home Equity Loans**

Home equity loans are a source of funds using the equity built up in a home. The original mortgage loan remains in place; the home equity loan is junior to the original lien. It is an alternative to refinancing and can be used for a variety of financial needs, such as to:

- finance the purchase of expensive items,
- consolidate existing installment loans on credit card debt, and
- pay medical, education, home improvement, or other expenses.

If the homeowner refinances, the original mortgage loan remains in place, and the home equity loan is junior to the original lien.

A home equity loan can be taken out as a fixed loan amount or as an equity line of credit. With the home equity line of credit, referred to as a HELOC, lenders extend a line of credit that borrowers can use at will. The homeowner must consider a number of factors before deciding to secure a home equity loan, including:

- the costs involved in obtaining a new mortgage loan or a home equity loan,
- current interest rates,
- total monthly payments, and
- income tax consequences.

## **FINANCING LEGISLATION**

### **Truth in Lending Act and Regulation Z**

Regulation Z, which was enacted pursuant to the Truth in Lending Act, by the Federal Trade Commission (FTC), requires that **credit institutions inform borrowers of the true cost of**

**obtaining credit.** With proper disclosures, borrowers can compare the costs of various lenders to avoid the uninformed use of credit. Regardless of the amount, however, Regulation Z applies when a credit transaction is secured by a residence. **The regulation does not apply to business or commercial loans or to agricultural loans of any amount.**

Under the Truth-in-Lending Act, Regulation Z, a **consumer must be fully informed of all finance charges, and the true interest rate before a transaction is completed.**

The total finance charge calculation or APR (Annual Percentage Rate) must include any:

- loan fees,
- finder's fees,
- service charges,
- points,
- interest

In the case of a mortgage loan made to finance the purchase of a dwelling, the lender must compute and disclose the annual percentage rate (APR) (Could be considered Actual Percentage Rate).

### **Creditor**

A creditor, for purposes of Regulation Z, is any person who extends consumer credit more than 25 times each year or more than 5 times each year if the transactions involve dwellings as security. The credit must be subject to a finance charge or payable in more than four installments by written agreement.

### **Three-day right of rescission**

In the case of many consumer credit transactions covered by Regulation Z, the borrower has three days in which to rescind the transaction by merely notifying the lender. However, this right of rescission does not apply to owner-occupied residential purchase-money, first mortgage, or deed of trust loans. It does, however, apply to refinancing a home mortgage or to a home equity loan.

### **Advertising**

Regulation Z provides strict **regulation of real estate advertisements** in all media (e.g., newspapers, flyers, signs, billboards, Websites, radio or television ads, direct mailings) that refer to mortgage financing terms. General phrases like "**flexible terms available**" may be used, but if details are given, then **all details in the transaction must be disclosed, including rate, down payment, term**, etc. they must comply with the act. The APR, which is calculated based on all charges rather than the interest rate alone, must be stated.

Specific credit terms, such as *down payment*, *monthly payment*, the *dollar amount of the finance charge*, or *term of the loan*, are referred to as **trigger terms**. These terms may not be advertised unless the advertisement includes the following information:

- Cash price
- Required down payment
- Number, amounts, and due dates of all payments
- Annual percentage rate



- Total of all payments to be made over the term of the mortgage (unless the advertised credit refers to a first mortgage or deed of trust to finance the acquisition of a dwelling)

### **Penalties**

Regulation Z provides penalties for noncompliance. The penalty for violation of an administrative order enforcing Regulation Z is \$10,000 for each day the violation continues. A fine of up to \$10,000 may be imposed for engaging in an unfair or deceptive practice. In addition, a creditor may be liable to a consumer for twice the amount of the finance charge, for a minimum of \$100 and a maximum of \$1,000, plus court costs, attorneys' fees, and any actual damages. A willful violation is a misdemeanor punishable by a fine of up to \$5,000, one year's imprisonment, or both.

### **Equal Credit Opportunity Act (ECOA)**

The federal Equal Credit Opportunity Act (ECOA) prohibits lenders and others who grant or arrange credit to consumers from discriminating against credit applicants on the basis of:

- race,
- color,
- religion,
- national origin,
- sex,
- marital status,
- age (provided the applicant is of legal age), or
- dependence on public assistance.

Furthermore, lenders and other creditors must inform all rejected credit applicants of the principal reasons for the denial or termination of credit. The notice must be provided in writing within 30 days. The ECOA also provides that a borrower is entitled to a copy of the appraisal report if the borrower paid for the appraisal.

### **Community Reinvestment Act (CRA)**

**Community reinvestment** refers to the responsibility of financial institutions to help meet their communities' needs for low-income and moderate-income housing. In 1977, Congress passed the **Community Reinvestment Act (CRA)**. Under the CRA, financial institutions are expected to:

- meet the deposit and credit needs of their communities.
- participate and invest in local community development and rehabilitation projects.
- participate in loan programs for housing, small businesses, and small farms.

The law requires any federally supervised financial institution to prepare a statement containing

- a definition of the geographic boundaries of its community
- an identification of the types of community reinvestment credit offered (such as residential housing loans, housing rehabilitation loans, small-business loans, commercial loans, and consumer loans); and
- comments from the public about the institution's performance in meeting its community's needs.

Financial institutions are **periodically reviewed by one of three federal financial supervisory agencies: The Comptroller of the Currency, the Federal Reserve's Board of Governors, or the Federal Deposit Insurance Corporation (FDIC)**. The institutions must post a public notice that their community reinvestment activities are subject to federal review, and they must make the results of these reviews public.

### **Real Estate Settlement Procedures Act (RESPA)**

The federal **Real Estate Settlement Procedures Act (RESPA)** applies to any residential real estate transaction involving a new first mortgage loan. RESPA is designed to **ensure that the buyer and seller are fully informed of all settlement costs**.

**NOTES:**

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## CHAPTER 7: REAL ESTATE APPRAISAL

### REAL ESTATE APPRAISAL PROCESS

#### **Appraisal**

An appraisal is an opinion of value based on supportable evidence and approved methods.

A **real estate appraisal** report is an opinion of market value on a property given to a lender or client with detailed and accurate information.

An **appraiser** is an independent person trained to provide an *unbiased* opinion of value in an impartial and objective manner, according to the appraisal process. Appraising is a professional service performed for a fee.

#### **Regulation of Appraisal Activities**

Title XI of the federal **Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)** requires that most appraisals used in connection with a federally related transaction be performed by someone licensed or certified by law.

A **federally related transaction** is any real estate-related financial transaction in which a federal financial institution or regulatory agency engages in, contracts for, or regulates and requires the services of an appraiser. This includes transactions involving the sale, lease, purchase, investment, or exchange of real property. It also includes the financing, refinancing, or the use of real property as security for a loan or an investment, including mortgage-backed securities.

**Federal law requires that appraisers be licensed or certified according to individual state law.**

State qualifications must conform to the federal requirements that, in turn, follow the criteria for certification established by the **Appraiser Qualifications Board of the Appraisal Foundation.**

**The Real Estate Appraiser Licensing Act of 2002**, as amended in 2009, provides for mandatory licensure with limited exceptions of Illinois appraisers. Illinois recognizes three categories of appraisers:

- **Associate real estate trainee appraiser - entry-level appraiser**; all reports must be cosigned by a state-certified residential real estate appraiser or state-certified general real estate appraiser.
- **Certified residential real estate appraiser** - qualified to appraise residential property of one unit to four units without regard to transaction value or complexity, but with restrictions in accordance with Title XI, USPAP, and criteria established by the Appraisal Qualifications Board (AQB).
- **Certified general real estate appraiser** - qualified to appraise all types of real property without restrictions as to the scope of practice subject to USPAP requirements.

**The appraiser must retain contracts, logs, and appraisal reports used in meeting pre-license experience requirements for a period of five years.**

**Only individuals** (not corporations, partnerships, firms, or groups) **may be certified as appraisers** or act as associate real estate appraisers. A certified appraiser may, however, sign appraisal reports on behalf of a business entity.

An appraisal report prepared by an appraiser recognized under the act **must identify on the report, by name, the individual who ordered or originated the appraisal assignment.** The appraiser must **retain the original copy** of all contracts engaging his services as an appraiser and all appraisal reports, including any supporting data used to develop the appraisal report, for a period of **not less than five years**, or two years after the final disposition of any judicial proceeding in which testimony was given, whichever is longer.

**The Real Estate Appraiser Licensing Act of 2002** established a fee structure and disciplinary and enforcement mechanism. Associate real estate trainee and certification candidates also must meet strict competency, educational, examination, and experience requirements. The appraisal profession requires all Illinois associate trainees to become certified residential appraisers within two years of initial licensure. An individual appraiser may *not* use the titles "state-certified" or "associate real estate trainee appraiser" unless he is recognized as such by the state.

### **Real Estate Broker Competitive Market Analysis**

Not all estimates of value are made by professional appraisers. **Real estate licensees often must help a seller arrive at a listing price or assist a buyer in determining an offering price for property without the aid of a formal appraisal report.** In such a case, the licensee would use a comparative market analysis (CMA). A CMA is distinctly different from an appraisal report offered by a licensed appraiser. An appraisal is based on an analysis of properties that have actually sold; the CMA, in contrast, features properties similar to the subject property in size, location, and amenities.

The CMA is based on:

- recently closed properties (solds),
- properties currently on the market (competition for the subject property), and
- properties that did not sell (expired listings in the area).

### **Broker's Price Opinion (BPO)**

A **broker's price opinion (BPO)** is a less expensive alternative of valuating properties often used by lenders working with home equity lines, refinancing, portfolio management, loss mitigation, and collections. **A BPO cannot be used if the matter involves a federally related transaction that requires an appraisal and/or the transaction occurs in a state that requires an appraiser's license.**

### **Value**

To have value in the real estate market that is, to have monetary worth based on desirability a property must have the following four characteristics:

1. Demand—The need or desire for possession or ownership backed by the financial means to satisfy that need

2. Utility—The property's usefulness for its intended purposes
3. Scarcity—A finite supply
4. Transferability—The relative ease with which ownership rights are transferred from one person to another

## Market Value

The market value of real estate is the most probable price that a property should bring in a fair sale. This definition makes three assumptions.

1. It presumes a competitive and open market.
2. The buyer and seller are both assumed to be acting prudently and knowledgeably.
3. Market value depends on the price not being affected by unusual circumstances.

The following are essential factors in rendering an opinion of value:

- The most probable price is not the average or highest price.
- The buyer and seller must be unrelated and acting without undue pressure.
- Both buyer and seller must be well informed about the property's use and potential, including both its defects and its advantages.
- A reasonable time must be allowed for exposure in the open market.
- Payment must be made in cash or its equivalent.
- The price must represent a normal consideration for the property sold, unaffected by special financing amounts or terms, services, fees, costs, or credits incurred in the market transaction.

## Market value versus market price

Market value is an opinion of value based on an analysis of data. The data may include not only an analysis of comparable sales but also an analysis of potential income, expenses, and replacement costs (less any depreciation). **Market price, on the other hand, is what a property actually sells for its sales price. Cost may not equal either market value or market price.**

## Market value versus cost

An important distinction can be made between market value and cost. One of the most common misconceptions about valuing property is that cost represents market value. **Cost and market value may be the same. In fact, when the improvements on a property are new, cost and value are likely to be equal. But more often, cost does not equal market value.**

For example, a homeowner may install a swimming pool for a cost of \$20,000; however, the cost of the improvement may not add \$20,000 to the value of the property.

## BASIC PRINCIPLES OF VALUE

### Anticipation

According to the principle of anticipation, value is created by the **expectation that certain events will occur**. Value can increase or decrease in anticipation of some future benefit or detriment.

### Change

**No physical or economic condition remains constant.** This is the principle of change. Real estate is subject to natural phenomena such as tornadoes, fires, and routine wear and tear. The real estate business is subject to market demands, as is any other business.

### Competition

**Competition is the *interaction* of supply and demand.** Excess profits tend to attract competition. For example, the success of a retail store may cause investors to open similar stores in the area.

### Conformity

The principle of conformity means that maximum value is created when a **property is in harmony with its surroundings**. Maximum value is realized if the **use of land conforms to existing neighborhood standards**. In single-family residential neighborhoods, for instance, buildings should be similar in design, construction, size, and age.

### Contribution

Under the principle of contribution, the **value of any part of a property is measured by its effect on the value of the whole**. Installing a swimming pool, greenhouse, or private bowling alley **may not add value to the property equal to the cost but** remodeling an outdated kitchen or bathroom might.

### Highest and best use

The **most profitable single use to which a property may be put**, or the use that is most likely to be in demand in the near future, is the property's **highest and best use**. The use must be:

- legally permitted,
- economically or financially feasible,
- physically possible, and
- the most profitable or maximally productive.

The highest and best use of a site can change with social, political, and economic forces. A parking lot in a busy downtown area, for example, may not maximize the land's profitability to the same extent an office would. Highest and best use is noted in every appraisal.

### Increasing and diminishing returns

The **addition of more improvements** to land and structures **increases total value only to the asset's maximum value**. Beyond that point, **additional improvements no longer affect a property's value**. As long as money spent on improvements produces an increase in income or value, the **law of increasing returns** applies. At the point where additional improvements do not increase income or value, the **law of diminishing returns** applies. No matter how much money is spent on the property, the property's value will not keep pace with the expenditures. A remodeled kitchen or bathroom might increase the value of a house; adding restaurant-quality appliances and gold faucets, however, would be a cost that the owner probably would not be able to recover.

## Plottage

**Plottage is when the total value of two adjacent properties may be greater if they are combined than the sum of their individual values if each is sold separately.** The principle of **plottage** holds that merging or consolidating adjacent lots into a single larger one produces a greater total land value than the sum of the two sites valued separately. **The process of merging two separately owned lots under one owner is known as assemblage.**

## Regression

- lowering of a property's value due to its neighbors.  
**Don't buy the best house on the worst block.**

## Progression:

- increasing of a property's value due to its neighbors.  
**Buy the worst house on the best block.**

## Substitution

Under the principle of **substitution**, the maximum value of a property tends to be set by how much it would **cost to purchase an equally desirable and valuable substitute** property. Substitution is the foundation of the sales comparison approach.

## Supply and demand

The principle of **supply and demand** holds that the value of a property depends on the number of properties available in the marketplace—the supply of the product. When supply increases, value decreases and when demand increases, value increases. Other factors include the prices of other properties, the number of prospective purchasers, and the price buyers will pay.

## THE THREE APPROACHES TO VALUE

### The Sales Comparison Approach

In the **sales comparison approach** (also known as the **market data approach**), an estimate of value is obtained by **comparing the property being appraised (the subject property) with recently sold comparable properties (properties similar to the subject, called comps)**. Because no two parcels of real estate are exactly alike, each comparable property must be **analyzed for differences and similarities between it and the subject property**. The elements of comparison for which adjustments must be made include the following:

- **Property rights:** An adjustment must be made when less than fee simple, the full legal bundle of rights, is involved. This includes land leases, ground rents, life estates, easements, deed restrictions, and encroachments.
- **Financing concessions:** The financing terms must be considered, including adjustments for differences such as mortgage loan terms and owner financing.
- **Market conditions:** Interest rates, supply and demand, and other economic indicators must be analyzed.
- **Conditions of sale:** Adjustments must be made for motivational factors that would affect the sale, such as foreclosure, a sale between family members, or some nonmonetary incentive.



- Market conditions since the date of sale: An adjustment must be made if economic changes occur between the date of sale of the comparable property and the date of the appraisal.
- Location or area preference: Similar properties might differ in price from neighborhood to neighborhood or even between locations within the same neighborhood.
- Physical features and amenities: Physical features, such as the structure's age, size, and condition, may require adjustments.

The sales comparison approach is considered the most reliable of the three approaches in appraising single-family homes, where the intangible benefits might be difficult to measure otherwise. Most appraisals include a minimum of three comparable sales reflective of the subject property.

Whenever possible, the **comparables should be recent (less than six months) and close by (less than a mile) to the subject property.**

Two condos in the same neighborhood, one that sold and one that is the subject of an appraisal, are very similar.

The comp sold for \$145,000 and has a garage valued at \$9,000. The subject property has no garage, but it has a fireplace valued at \$5,000. What is the indicated value of the property?

Take the selling price of the comp and add or subtract for any differences, one at a time, from the subject property.

The rules are CBS and CPA:

- CBS = if the Comp is Better, Subtract.
- CPA = if the Comp is Poorer, Add

\$145,000 The comp sale price  
- \$9,000 (The Comp is Better, Subtract—CBS)  
+ \$5,000 (The Comp is Poorer, Add —CPA)  
\$141,000 The indicated value of the subject property

### **Sales comparison/Market Data Approach**

An appraiser needs to find out the value of a house (subject property). She found two comparables:

Comparable #1 sold for \$375,000 and has a swimming pool, which the subject property does not have. The value of a swimming pool is \$21,500.

Comparable #2 sold for \$321,000 but has one less bedroom. The value of a bedroom is \$32,000.

What is the value of the subject property? Remember that the adjustments are always made on the comparable properties, never on the subject property.

<b>Comparable #1</b>	Sold for	\$375,000
Value of the swimming pool		- \$21,500
Equals adjusted price		\$351,500
 <b>Comparable #2</b>	 Sold for	 \$321,000
Value of a bedroom		+ \$32,000
Equals adjusted price		\$353,000

Add the adjusted price of both properties and then divide by two, **value of the subject property is \$352,250.**

### The Cost Approach

**The cost approach** to value also is based on the principle of substitution. The cost approach consists of five steps:

1. Estimate the value of the land as if it were vacant and available to be put to its highest and best use.
2. Estimate the current cost of constructing the buildings and improvements.
3. Estimate the amount of accrued depreciation resulting from the property's physical deterioration, functional obsolescence, and external depreciation.
4. Deduct the accrued depreciation (Step 3) from the current construction cost (Step 2).
5. Add the estimated land value (Step 1) to the depreciated cost of the building and site improvements (Step 4) to arrive at the total property value.

Current cost of construction = \$185,000

Accrued depreciation = \$30,000

Value of the land = \$55,000

$\$185,000 - \$30,000 + \$55,000 = \$210,000$

In this example, the total property value is \$210,000.

There are two ways to look at the construction cost of a building for appraisal purposes: reproduction cost and replacement cost.

1. **Reproduction cost** is the **construction cost at current prices of an exact duplicate** of the subject improvement, including both the benefits and the drawbacks of the property.
2. **Replacement cost** is the **cost to construct an improvement similar to the subject property** using current construction methods and materials, but **not necessarily an exact duplicate.** **Replacement cost** is more frequently used in appraising older structures because it eliminates obsolete features and takes advantage of current construction materials and techniques.

## Determining reproduction or replacement cost

An appraiser using the cost approach computes the reproduction or replacement cost of a building using one of the following four methods:

- **Square-foot method - This is the most common and easiest method of cost estimation.** The cost per square foot of a recently built comparable structure is multiplied by the number of square feet (using exterior dimensions) in the subject building.
- **Unit-in-place method -** In the unit-in-place method, the replacement cost of a structure is estimated based on the **construction cost per unit of measure of individual building components**, including material, labor, overhead, and builder's profit. The sum of the components is the cost of the new structure.
- **Quantity-survey method -** The quantity and quality of all materials (such as lumber, brick, and plaster) and the labor are estimated on a unit cost basis. These factors are added to indirect costs (e.g., building permit, survey, payroll, taxes, and builder's profit) to arrive at the total cost of the structure. Because it is so detailed and time-consuming, this method is usually used only in appraising historical properties. It is, however, the most accurate method of appraising new construction.
- **Index method - A factor representing the percentage increase of construction costs** up to the present time is applied to the original cost of the subject property. Because it fails to consider individual property variables, this method is useful only as a check of the estimate reached by one of the other methods.

## Depreciation

In a real estate appraisal, **depreciation is a loss in value** due to any cause compared with today's cost of replacement. It refers to a condition that adversely affects the value of an improvement to real property.

**Land does not depreciate, it retains its value indefinitely**, except in such rare cases as downzoned urban parcels, improperly developed land, or misused farmland. Depreciation is the result of a negative condition that affects real property.

Depreciation is considered to be **curable or incurable**, depending on the contribution of the expenditure to the value of the property. For appraisal purposes, depreciation is divided into three classes, according to its cause:

### Physical deterioration

A *curable* item is one in need of repair, such as painting (deferred maintenance), that is economically feasible and would result in an increase in value equal to or exceeding the cost. An item is *incurable* if it is a defect caused by physical wear and tear and if its correction would not be economically feasible or contribute a comparable value to the building, such as a crack in the foundation. The cost of a major repair may not warrant the financial investment.

### Functional obsolescence

Obsolescence means a loss in value from the market's response to the item. **Outmoded or unacceptable physical or design features that are no longer considered desirable by purchasers are considered**

**curable**. Such features could be replaced or redesigned at a cost that would be offset by the anticipated increase in ultimate value.

**Incurable obsolescence** includes undesirable physical or design features that cannot be easily remedied because the **cost of cure would be greater than its resulting increase in value**.

### **External obsolescence (Economic obsolescence)**

If caused by **negative factors not on the subject property**, such as zoning, environmental, social, or economic forces, the depreciation is **always incurable**. The loss in value cannot be reversed by spending money on the property. Improvements to the property prolongs the **economic life** of a property.

The **cost approach** is most helpful in the appraisal of **newer or special-purpose buildings such as schools, churches, and public buildings**. Such properties are difficult to appraise using other methods because there are seldom enough local sales to use as comparables and because the properties do not ordinarily generate income.

### **The Income Approach**

The **income approach** to value is based on the **present value of the rights to future income**. It assumes that the **income generated by a property will determine the property's value**.

The income approach is used for valuation of income-producing properties such as **apartment buildings, office buildings, and shopping centers**. In estimating value using the income approach, an appraiser must take five steps:

1. Estimate **annual gross income**. Current rental income may not reflect the current market rental rates, especially in the case of short-term leases or leases about to terminate so current rental income may be adjusted by an investor. Income also includes other income to the property from such sources as vending machines, parking fees, and laundry machines.
2. Deduct an appropriate allowance for vacancy and rent loss, based on the appraiser's experience, and arrive at effective gross income.
3. Deduct the annual operating expenses, from the effective gross income to arrive at the annual net operating income (**NOI**). Management costs are always included, even if the current owner manages the property. **Mortgage payments (principal and interest) are debt service and not considered operating expenses**. Replacement of Capital items is handled by an allowance (reserve) representing the annual usage of each major capital item and included in the operating expenses.
4. Estimate the price a typical investor would pay for the income produced by this particular type and class of property. This is done by estimating the rate of return (or yield) that an investor will demand for the investment of capital in this type of building. This rate of return is called the capitalization (or "cap") rate and is determined by comparing the relationship of net operating income to the sales prices of similar properties that have sold in the current market.
5. Apply the capitalization rate to the property's annual net operating income to arrive at the estimate of the property's value.

With the appropriate capitalization rate and the projected annual net operating income, the appraiser can obtain an indication of value by the income approach.

Determining the value of an income property using the income approach:

Annual Gross Income	\$216,000
Less Vacancy	<u>-\$10,800</u>
Equals Effective Gross Income	\$205,200
Less Expenses	<u>-\$96,500</u>
Equals NOI (Net Operating Income)	\$108,700
Divide Capitalization rate into NOI	<u>\$108,700/6.4%</u>
Equals Value	\$1,698,437.50

This formula and its variations are important in dealing with income property:

Income ÷ Rate = Value

Income ÷ Value = Rate

Value x Rate = Income

As the cap rate goes **down**, the value **increases**

As the cap rate goes **up**, the value **decreases**

### **Gross Rent Multiplier (GRM)**

A quick way to estimate the income of a property is the **Gross Rent Multiplier (GRM)**. To estimate the income of a property you'd have to take 4 to 6 properties in the same area that have sold already and follow the formula:

### **Sale Price / Monthly Rent = GRM (of the sold property)**

Get the average GRM of the 4 to 6 properties then get the monthly rent of the property you are estimating the income for and multiply it by the average GRM to get the approximate value of the property. (Monthly rent x Average GRM of 4-6 properties = Value of Property)

### **Gross Rent Multiplier**

To find out the value of a smaller income-producing property:

Monthly Rent	\$2,200
Times GRM	<u>X 120</u>
Equals Value	\$264,000

To find the average GRM:

The appraiser will use 4-6 properties that have sold and divide the sold price by the monthly rent to find out the GRM.

Sold Price	\$327,000
Divide monthly rent	<u>/ \$2,400</u>
Equals GRM	136.25

## THE APPRAISAL PROCESS

Although appraising is not an exact or a precise science, the key to an accurate appraisal lies in the **methodical collection and analysis of data**. The appraisal process is an orderly set of procedures used to collect and analyze data to arrive at an ultimate value conclusion. The data are divided into two basic classes:

1. General data, which covers the nation, region, city, and neighborhood. Of particular importance is the neighborhood, where an appraiser finds the physical, economic, social, and political influences that directly affect the value and potential of the subject property.
2. Specific data, which covers details of the subject property as well as comparative data relating to costs, sales, and income and expenses of properties similar to and competitive with the subject property.

Once the approaches have been reconciled and an opinion of value has been reached, the appraiser prepares a report for the client. The report should:

- identify the real estate and real property interest being appraised,
- state the purpose and intended use of the appraisal,
- define the value to be estimated,
- state the effective date of the value and the date of the report,
- state the extent of the process of collecting, confirming, and reporting the data,
- list all assumptions and limiting conditions that affect the analysis, opinion, and conclusions of value,
- describe the information considered, the appraisal procedures followed, and the reasoning that supports the report's conclusions; if an approach was excluded, the report should explain why,
- describe (if necessary or appropriate) the appraiser's opinion of the highest and best use of the real estate,
- describe any additional information that may be appropriate to show compliance with the specific guidelines established in the USPAP or to clearly identify and explain any departures from these guidelines, and
- include signed certification, as required by the USPAP.

**Reconciliation** is the final step in the appraisal process, in which the appraiser reconciles the estimates of value received from the market-data, cost, and income approaches to arrive at a final estimate of market value for the subject property.

Sellers and real estate licensees may not agree with the appraiser's value and may argue that it is lower than they think that it should be. However, **since most appraisals are ordered by lenders who base their loan on this value**, the appraiser must be able to back up the appraisal report with quantifiable conclusions; in the event of a loan default, at what value can the property most probably be sold for the lender to recover the remaining loan balance?

**NOTES:**

[illegible]

## CHAPTER 8: ENVIRONMENTAL ISSUES

### ILLINOIS ENVIRONMENTAL CONTROLS

The Illinois Environmental Protection Agency (IEPA) is charged with **maintaining and enhancing the state's air, land, and water quality** through education, inspection, regulation, enforcement, recycling, and prevention activities. The **Pollution Control Board** and **Hazardous Waste Advisory Council** are two of the many bodies created to assist the IEPA in specific areas. Most Illinois environmental regulations are required by statute to be "identical in substance" to environmental protection regulations established by the U.S. Environmental Protection Agency (EPA).

### HAZARDOUS SUBSTANCES

#### Asbestos

Asbestos is a fire-resistant mineral that was once **used extensively as insulation and to strengthen other materials**. A component of more than 3,000 types of building materials, asbestos was found in most construction, including residential, until **1978 when its use was banned**. The EPA estimates that, even today, about **20 percent of the nation's commercial and public buildings have asbestos-containing materials (ACMs)**.

**Asbestos was used to cover pipes, ducts, and heating and hot water units**. Its fire-resistant properties made it a popular material for use in **floor tile, exterior siding, roofing products, linoleum flooring materials, joint compounds, wallboard material, backing, and mastics**. Though some ACMs are easy to identify (e.g., insulation around heating and water pipes), identifying asbestos may be more difficult when it is behind walls or under floors.

Asbestos is **highly friable, meaning that as it ages, asbestos fibers break down easily into tiny filaments and particles**. This makes asbestos especially harmful when it is disturbed or exposed and becomes airborne, as often occurs during renovation or remodeling. **Those who have inhaled asbestos fibers often develop serious and deadly respiratory diseases decades later**. While federal regulations establish guidelines for owners of public and commercial buildings to test for asbestos-containing materials, **there are no guidelines regarding the presence of asbestos in residential properties**.

Because **improper removal procedures may further contaminate the air** within the structure, the process requires **state-licensed technicians and specially sealed environments**. The waste generated must be disposed of at a licensed facility, which further adds to the cost of removal. **Encapsulation**, or the sealing off of disintegrating asbestos, is an alternate method of asbestos control that may be preferable to removal in certain circumstances. However, an owner must periodically monitor the condition of the encapsulated asbestos to make sure it is not disintegrating.

**Only a certified asbestos inspector should perform an asbestos inspection of a structure to identify which building materials may contain asbestos**. The inspector can also provide recommendations and costs associated with remediation. It is vital that a buyer knows where asbestos-containing materials are located so that they are not disturbed during any repair, remodeling, demolition, or even routine use. Appraisers also should be aware of the possible presence of asbestos.



## Lead-Based Paint and Other Lead Hazards

**Lead** was used as a pigment and drying agent in alkyd oil-based paint. Lead-based paint may be on any interior or exterior surface, but it is **particularly common on doors, windows, and other woodwork**. The federal government estimates **that lead is present in about 75 percent of all private housing built before 1978**, or approximately 57 million homes, ranging from low-income apartments to million-dollar mansions.

**Children younger than six are the most vulnerable to damage from excessive lead levels.** Elevated levels of lead in children cause learning disabilities, developmental delays, reduced height, and poor hearing, and the effects are generally irreversible. Excessive exposure in adults can induce anemia and hypertension, trigger gallbladder problems, and cause reproductive problems in both men and women.

Lead dust can be ingested from the hands by a crawling infant; inhaled by any occupant of a structure or ingested from the water supply because of lead pipes or lead solder. Soil and groundwater may be contaminated by everything from lead plumbing in leaking landfills to discarded skeets and bullets from an old shooting range. High levels of lead have been found in soil located near waste-to-energy incinerators.

In 1996, the EPA and the Department of Housing and Urban Development (HUD) issued final regulations, known as the **Lead-Based Paint Hazard Reduction Act (LBPBRA) of 1992**, which requires the disclosure of the presence of any known lead-based paint hazards to potential buyers or renters. The federal law does not require that anyone test for the presence of lead-based paint.

**LBPBRA** requires the following from sellers and landlords of residential dwellings built **before 1978**:

- Landlords must disclose known information on lead-based paint and hazards before leases take effect. Leases must include a disclosure form regarding lead-based paint.
- Sellers have to disclose known information on lead-based paint and hazards prior to an execution of a contract for sale. Sales contracts must include a completed disclosure form about lead-based paint. This is the form for sellers and is slightly different from the form for landlords. Licensees should use EPA-written disclosure forms rather than creating their own forms.
- Buyers have up to ten days to conduct a risk assessment or an inspection for the presence of lead-based paint hazards.
- Licensees provide buyers and lessees with "**Protect Your Family from Lead in Your Home**," the pamphlet created by the EPA, HUD, and the U.S. Consumer Product Safety Commission.
- Renovators must give homeowners the "**Protect Your Family from Lead in Your Home**" pamphlet before starting any renovation work.
- Beginning April 2010, federal law requires anyone who is paid to perform work that disturbs paint in housing and child-occupied facilities to be trained and certified in the EPA's new lead-based work practices. This includes residential rental property owners/managers, general contractors, and special trade contractors (e.g., painters, plumbers, carpenters, electricians). The **Renovation, Repair, and Painting (RR&P)** program involves pre-renovation education. This education includes distribution of the pamphlet "**Renovate Right**" to the property owners before work commences.

- Licensees must ensure that all parties comply with the law.
- Sellers, lessors, and renovators are required to disclose any prior test results or any knowledge of lead-based paint hazards. With only a very narrow exception, all real estate licensees (subagent, buyer's agent, and facilitator) are required to advise sellers to make the required disclosures. Only buyer's agents who are paid entirely by the buyer are exempt.

The regulations apply to housing built prior to 1978 with the following **six exceptions**:

1. Property sold at foreclosure, although the disclosure must be made at resale time
2. Rental property that is certified "lead-based paint free" by an inspector who is certified under a federal program or federally authorized state certification program
3. Property leased for 100 days or less, with no lease renewal or extension
4. Renewals of existing leases if disclosure was made at the time of the initial lease
5. Units with no bedrooms or with no separation between sleeping and living areas
6. Housing for the elderly or disabled if children under the age of six are not expected to live there

There is considerable controversy about practical approaches for handling the presence of lead-based paint. **Removal or encapsulation is sometimes utilized.** Federal law requires that only licensed lead inspectors, abatement contractors, risk assessors, abatement project designers, and abatement workers may deal with the removal or encapsulation of lead in a structure.

Anyone who performs lead abatement or mitigation activities without a license is guilty of a Class A misdemeanor. The Department of Public Health (DPH) oversees the qualifying, training, and licensing of lead abatement contractors and lead abatement workers in Illinois.

EPA guidance pamphlets and other information about lead-based hazards are available from the **National Lead Information Center at (800) 424-5323.**

The **Illinois Lead Poisoning Prevention Act (410 ILCS 45)** requires that physicians screen children younger than six years old for lead poisoning when the child lives in an area considered by the state to be at "high risk" for lead exposure. High-risk areas include slum and blighted housing, proximity to highway or heavy local traffic; proximity to a lead-using or if the inspection identifies a lead hazard, the property owner is required to mitigate the condition within 90 days (30 days if a child under six or a pregnant woman is at risk). Licensed lead abatement contractors must be used for lead removal. The owner will receive a certificate of compliance once the DPH is satisfied that the lead hazard has been removed.

An owner who has received a lead mitigation notice must provide any prospective lessees for the affected unit with a written notice of the existence of an identified lead hazard. In addition, all owners of residential buildings or units must give current and prospective lessees information on the potential health hazards posed by lead and a copy of an informational brochure.

**1978 is a year to remember. Lead paint and asbestos were both banned. Unleaded gasoline still has lead in it so automobile's exhaust fumes are considered to be one of the sources of lead.**

## Radon

**Radon** is a naturally occurring, colorless, odorless, tasteless, radioactive gas produced by the decay of other radioactive substances. Radon is measured in picocuries (a unit of radiation) contained in a liter of air (i.e., pCi/L). **Radon is found in every state and territory**, with radon levels in the outdoor air averaging 0.4 pCi/L. Fans and thermal "stack effects" (i.e., rising hot air draws cooler air in from the ground through cracks in the basement and foundation walls) pulls radon into buildings.

**The potential for developing lung cancer from exposure to radon is directly correlated to the extent and length of a person's exposure to radon. Radon has been classified as a "Class A", known human carcinogen. Furthermore, smokers have a risk factor 15 times greater than nonsmokers.**

Because neither the EPA nor current scientific consensus has been able to establish a "threshold" safe level of radon exposure, the EPA suggests an "action" level of 4 pCi/L. The action level of 4 was chosen because 95 percent of the time, current technology can bring the level below 4, and 75 percent of the time, levels can be reduced to 2 pCi/L. Radon mitigation is less expensive when the system is installed during construction; **mitigation consists of removing the radon before it seeps into the house. A fan is installed in a pipe running from the basement to the attic to draw the radon up and out.**

**The Illinois Radon Awareness Act** requires a seller to provide to a buyer, before the buyer is obligated under any contract to purchase residential real property, a Disclosure of Information on Radon Hazards along with a pamphlet entitled "*Radon Testing Guidelines for Real Estate Transactions*" stating that the property may present the potential for exposure to radon.

In short, the act requires a separate disclosure document for radon to be included in the majority of residential real estate transactions. The disclosure document:

- has a radon warning statement advising buyers that the home may pose a threat to their health if it has elevated levels of radon and that all homes should be tested for radon,
- requires that a seller provide an Illinois Emergency Management Agency (IEMA) approved pamphlet about general radon information to a buyer and disclose all information along with any available documentation of the radon levels in the home,
- requires that real estate agents sign the disclosure to confirm that seller has been made aware of his/her obligations,
- requires that all parties involved sign the disclosure acknowledging the transfer of the above information, and
- requires that sellers must disclose that they have no knowledge of elevated radon concentrations or that prior elevated radon concentrations have been mitigated or remediated.

**The act does not require that all homes in a real estate transaction be tested or that the home be mitigated if the test results are elevated.** It also **does not apply** to the transfer of any residential dwelling unit located **three stories (or higher) above ground** level in any structure.

If any of the required disclosures occur after the buyer has made an offer to purchase the residential real property, the seller shall complete the required disclosure activities prior to accepting the buyer's offer and allow the buyer an opportunity to review the information and possibly amend the offer.

The provisions of this act do not apply to:

- transfers pursuant to court order,
- transfers from a mortgagor to a mortgagee by deed in lieu of foreclosure or consent judgment, transfer by judicial deed issued pursuant to a foreclosure sale, transfer by a collateral assignment of a beneficial interest of a land trust, or a transfer by a mortgagee or a successor in interest to the mortgagee's secured position,
- transfers by a fiduciary in the course of the administration of a decedent's estate, guardianship, conservatorship, or trust,
- transfers from one co-owner to one or more other co-owners,
- transfers pursuant to testate or intestate succession,
- transfers made to a spouse or to a person or persons in the lineal line of consanguinity of one or more of the sellers,
- transfers from an entity that has taken title to residential real property from a seller for the purpose of assisting in the relocation of the seller, so long as the entity makes available to all prospective buyers a copy of the disclosure form furnished to the entity by the seller,
- transfers to or from any governmental entity, and
- transfers of any residential dwelling unit located three stories (or higher) above ground level in any structure.

### Formaldehyde

Formaldehyde, a colorless chemical with a strong, pronounced odor, is used widely in the manufacturing of building materials and many household products because of its preservative characteristics. Often emitted as a gas, formaldehyde is one of the most common and problematic volatile organic compounds (VOCs) and is one of the few indoor air pollutants that can be measured.

**Formaldehyde was listed as a hazardous air pollutant in the Clean Air Act Amendments of 1990.**

The largest source of formaldehyde in any building is likely to be the off-gassing from pressed-wood products made from using adhesives that contain urea-formaldehyde (UF) resins. It is also used in carpeting and ceiling tiles. Urea-formaldehyde foam insulation (UFFI), once popular, then banned, and now legal again, is rarely used.

### Carbon Monoxide

Carbon monoxide (CO) is a **colorless, odorless gas that occurs due to incomplete combustion as a by-product of burning such fuels as wood, oil, and natural gas.** Furnaces, water heaters, space heaters, fireplaces, and wood stoves all produce CO as a natural result of combustion. When these appliances function properly and are properly ventilated, CO emissions are not a problem. However, **when improper ventilation or equipment malfunctions permit large quantities of CO to be released into a residence or commercial structure, it poses a significant health hazard.** More than 300 deaths from carbon monoxide poisoning occur each year, with thousands of others

requiring hospital emergency room care. **Illinois requires that all residences be equipped with working carbon monoxide detectors.**

### **Polychlorinated biphenyls (PCBs)**

These consist of more than 200 chemical compounds that are not found naturally in nature. Flame resistant, they **were often used in electrical equipment such as transformers, electrical motors in refrigerators, caulking compounds, and hydraulic oil in older equipment.** The EPA has classified PCBs as reasonably carcinogenic, and they have been implicated in lower fertility and shortened life spans. Although the commercial distribution of **PCBs was banned in 1979, PCBs remain in the environment because burning them at more than 2,400 degrees in a closed environment is the only known way to destroy them.**

PCBs are most likely a concern for commercial and industrial property managers. These managers should ask **the local utility company to identify and remove any type of transformer that might be a source of PCBs.** If the PCBs leak into the environment, **penalties and removal methods are expensive.**

### **Chlorofluorocarbons**

**Chlorofluorocarbons (CFCs)** are nontoxic, nonflammable chemicals containing atoms of carbon, chlorine, and fluorine. CFCs are most **often used in air conditioners, refrigerators, aerosol sprays, paints, solvents, and foam blowing applications.** Although CFCs are safe in most applications and are inert in the lower atmosphere, once CFC vapors rise to the upper atmosphere, they can deplete ozone.

### **Electromagnetic Fields**

Electromagnetic fields (EMFs) are generated by the movement of electrical currents. **The use of any electrical appliance creates a small field of electromagnetic radiation;** clock radios, blow-dryers, televisions, and computers all produce EMFs. **The major concern regarding EMFs involves high-tension power lines.** The EMFs produced by these high-voltage lines, as well as by secondary distribution lines and transformers, are **suspected of causing cancer, hormonal changes, and behavioral abnormalities.** There is considerable controversy (and much conflicting evidence) about whether EMFs pose a health hazard.

### **Mold**

Mold can be found almost anywhere and can grow on almost any organic substance, so long as moisture, oxygen, and an organic food source are present. **Moisture feeds mold growth.** If a moisture problem is not discovered or addressed, mold growth can gradually destroy what it is growing on. There are over 2,000 types of mold. Mold can grow in sunlight, darkness, dry air and in moisture. Today many people are affected by mold, especially children. Newer homes today often have higher concentrations of mold compared to older homes. Newer homes are more tightly sealed and do not allow for air circulation. One way of minimizing mold growth is to vent all areas of the home especially bathrooms and basements.

**In addition, some molds can cause serious health problems.** They can trigger allergic reactions and asthma attacks. Some molds are known to produce potent toxins and/or irritants.

**Some moisture problems in homes and buildings have been directly linked to recent changes in construction practices.** Some of these practices have resulted in **buildings that are too tightly sealed**, preventing adequate ventilation.

The EPA has published guidelines for the remediation and/or cleanup of mold and moisture problems in schools and commercial buildings. The **Illinois Toxic and Pathogenic Mold Prevention Act** requires the Department of Public Health to adopt standards for reducing the occurrence of mold contamination in indoor environments. This law requires that owners of residential, commercial, and industrial properties disclose to all prospective buyers the existence of indoor mold.

Remember, as real estate agents, we are not experts in identifying mold or advising property owners on the removal of any mold hazards. If your client has any questions about possible mold contamination, always refer your client to a licensed and certified expert for an evaluation and assessment report. Mold removal must be done by a licensed mold remediator only.

**HUD now requires mold disclosure on all HUD sales contracts. Mold disclosure forms are available through your state or local REALTOR® association.**

### **Groundwater Protection**

Groundwater is the **water that exists under the earth's surface within the tiny spaces or crevices in geological formations.** Groundwater forms the water table, the natural level at which the ground is saturated. The water table may be several hundred feet underground or near the surface. When the earth's natural filtering systems are inadequate to ensure the availability of pure water, **any contamination of underground water threatens the supply of pure, clean water for private wells or public water systems.** Numerous state and federal laws have been enacted to preserve and protect the water supply.

Water can be contaminated from a number of sources. Runoff from waste disposal sites, leaking underground storage tanks, and pesticides and herbicides are some of the main culprits. Because water flows naturally, contamination can spread far from its source. Once contamination has been identified, its source can usually be eliminated, and the water may eventually become or be made clean. However, the process can be time-consuming and expensive.

Many property disclosure forms require sellers to identify the property's water source, such as well water, municipal water supply, or some other source. Anything other than a municipal water supply should be tested. Also, sellers are generally required to identify the type of septic system because an incorrectly placed or poorly functioning system can contaminate the water source.

### **Underground Storage Tanks**

Underground storage tanks (USTs) are commonly found on **sites where petroleum products are used or where gas stations and auto repair shops are located.** They also may be found in a number of other commercial and industrial establishments including **printing and chemical plants, wood treatment plants, paper mills, paint manufacturers, dry cleaners, and food-processing plants for storing chemicals or process wastes.** Military bases and airports are also common sites for underground tanks. In residential areas, they are used to store heating oil.

Some tanks are currently in use, but many are long forgotten. Over time, neglected tanks may leak hazardous substances into the environment, **permitting contaminants to pollute not only the soil around the tank but also adjacent parcels and groundwater.** Licensees should be particularly alert to the presence of fill pipes, vent lines, stained soil, and fumes or odors, any of which may indicate the presence of a UST.

**State and federal laws impose strict requirements on landowners to detect and correct leaks in an effort to protect the groundwater.** The federal UST program is regulated by the EPA. The regulations apply to tanks that contain hazardous substances or liquid petroleum products and that **store at least 10 percent of their volume underground. UST owners are required to register their tanks and adhere to strict technical and administrative requirements that govern:**

- Installation,
- Maintenance,
- Corrosion prevention,
- Overspill prevention,
- Monitoring, and
- Record-keeping.

Owners are also required to demonstrate that they have sufficient financial resources to cover any damage that might result from leaks.

The following types of tanks are among those that are exempt from the federal regulations:

- Tanks that hold less than 110 gallons
- Farm and residential tanks that hold 1,100 gallons or less of motor fuel used for noncommercial purposes
- Tanks that store heating oil burned on the premises
- Tanks on or above the floor of underground areas such as basements or tunnels
- Septic tanks and systems for collecting stormwater and wastewater

In Illinois, the **Leaking Underground Storage Tank (LUST)** program governs the detection, identification, monitoring, mitigation, and removal of buried underground storage tanks (particularly those containing petroleum products). The program is administered by the state fire marshal and the IEPA and is authorized to disburse money from a special fund to assist property owners in complying with mandatory remediation activities.

## **Waste Disposal Sites**

Federal, state, and local regulations govern the location, construction, content, and maintenance of landfill sites built to accommodate the vast quantities of garbage produced every day in America. A landfill is an enormous hole, either excavated for the purpose of waste disposal or left over from surface mining operations. The hole is lined with clay or a synthetic liner to prevent leakage of waste material into the water supply. A system of underground drainage pipes permits the monitoring of leaks and leaching. Waste is laid on the liner at the bottom of the excavation, and a layer of topsoil is then compacted onto the waste. The layering procedure is repeated until the landfill is full, with the layers mounded up sometimes as high as several hundred feet.

## ENVIRONMENTAL PROTECTION

The majority of legislation dealing with environmental problems has been enacted within the past four decades. Although the Environmental Protection Agency (EPA) was created in 1970 at the federal level to oversee such problems, several other federal agencies' areas of concern generally overlap. The federal laws were created to encourage state and local governments to enact their own legislation.

### CERCLA— Superfund

The **Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)** was **created in 1980**. It established a fund of \$9 billion, called the Superfund, to clean up uncontrolled hazardous waste sites and to respond to spills. It created a process for identifying potentially responsible parties (PRPs) and ordering them to take responsibility for the cleanup action. CERCLA is administered and enforced by the EPA.

### Liability

Landowners are liable under CERCLA when a release (or a threat of release) of a hazardous substance has occurred on their property. Regardless of whether the contamination is the result of the landowner's actions or those of others, **the owner can be held responsible for the cleanup**. This liability includes the cleanup not only of the landowner's property but also of any neighboring property that has been contaminated. A landowner who is not responsible for the contamination can seek recovery reimbursement for the cleanup cost from previous landowners, any other responsible party, or the Superfund. However, if other parties are not available, even a landowner who did not cause the problem could be solely responsible for the costs.

Once the EPA determines that hazardous material has been released into the environment, it is authorized to begin remedial action. First, it attempts to identify the PRPs. If the PRPs agree to cooperate in the cleanup, they must agree about how to divide the cost. If the PRPs do not voluntarily undertake the cleanup, the EPA may hire its own contractors to do the necessary work. The EPA then bills the PRPs for the cost. If the PRPs refuse to pay, the EPA can seek damages in court for up to three times the actual cost of the cleanup.

**Liability** under the Superfund is considered to be **strict, joint and several, and retroactive**. **Strict liability means that the owner is responsible to the injured party without excuse**. Joint and several liability means that each of the individual owners is personally responsible for the total damages. If only one of the owners is financially able to handle the total damages, that owner must pay the total and collect the proportionate shares from the other owners whenever possible. Retroactive liability means that the liability is not limited to the current owner but includes people who have owned the site in the past.

### Superfund Amendments and Reauthorization Act

In 1986, the U.S. Congress reauthorized the **Superfund Amendments and Reauthorization Act (SARA)**. The amended statute contains stronger cleanup standards for contaminated sites and **five times** the funding of the original Superfund, which expired in September 1985.



The amended act also sought to **clarify the obligations of lenders**. As mentioned, liability under the Superfund extends to both the present and all previous owners of the contaminated site. Real estate lenders found themselves either as present owners or somewhere in the chain of ownership through foreclosure proceedings.

The amendments created a concept called **innocent landowner immunity**. It was recognized that in certain cases, a landowner in the chain of ownership was completely innocent of all wrongdoing and therefore should not be held liable. The innocent landowner immunity clause established the criteria by which to judge whether a person or business could be exempted from liability. The criteria included the following:

- The pollution was caused by a third party.
- The property was acquired after the fact.
- The landowner had no actual or constructive knowledge of the damage.
- Due care was exercised when the property was purchased (the landowner made a reasonable search, called an *environmental site assessment*) to determine that no damage to the property existed.
- Reasonable precautions were taken in the exercise of ownership rights.

### In Practice

The EPA has conducted a number of studies to determine the impact on surrounding property values with regard to proximity to landfills and hazardous waste sites. In the report "Challenges in Applying Property Value Studies to Assess the Benefits of the Superfund Program," released January 2009, the EPA concluded the following:

- Impacts on surrounding residential property values vary in size and direction.
- Expected declines have been found but increases in property values around Super-fund sites have also been found.
- The direction of the price effect on surrounding home values appears to vary significantly with individual sites.
- Remedial action can reverse the decline at some sites.
- Delays in cleanup result in a more permanent decline in value.

### Liability of Real Estate Licensees

Environmental law is relatively new. Although federal and state laws have defined many of the liabilities involved, common law is being used for further interpretation. Real estate licensees and **all** others involved in a real estate transaction must be aware of both actual and potential liability.

Sellers often carry the most legal liability exposure. Innocent landowners might be held responsible, even though they did not know about the presence of environmental hazards. Purchasers may be held liable, even if they didn't cause the contamination. Lenders may end up owning worthless assets if owners default on the loans rather than undertaking expensive cleanup efforts. Real estate licensees could be held liable for improper disclosure; therefore, it is necessary to be aware of the potential environmental risks from neighboring properties such as gas stations, manufacturing plants, or even funeral homes.

## DISCOVERY OF ENVIRONMENTAL HAZARDS

**Real estate licensees are not expected to have the technical expertise necessary to discover the presence of environmental hazards.** However, because they are presumed by the public to have special knowledge about real estate, licensees must be aware both of possible hazards and of where to seek professional help.

The most appropriate people on whom a real estate licensee can rely for sound environmental information are scientific or technical experts. Environmental auditors (or *environmental assessors*) are scientific or technical experts who can provide the most comprehensive studies.

Not only do environmental experts detect environmental problems, but they can also usually offer guidance about how best to resolve the conditions. Although environmental audits or assessments may occur at any stage in a transaction, they are most frequently a contingency that must be satisfied prior to closing.

### Environmental Site Assessments

An environmental site assessment is often performed on a property to show that due care was exercised in **determining if any environmental impairments exist**. The assessment can help prevent parties from becoming involved in contaminated property and work as a defense to liability. It is **often requested by a lending institution, developer, or a potential buyer**. The assessment is commonly performed in phases, such as Phase 1 or Phase 2.

A Phase 1 environmental report is requested first to determine if any potential environmental problems exist at or near the subject property that may cause impairment. This consists of a visual inspection of the site and an inspection of any appropriate documentation. Phase 2 is the Testing phase. Phase 3 is the Mitigation Phase, where the contamination is removed or mitigated.

There are no federal regulations that define what an environmental assessment must include. However, one of the most accepted industry standards is provided by the **American Society for Testing Materials International**.

A federally funded project requires that an **environmental impact statement** (EIS) be performed. These statements detail the impact the project will have on the environment. They can include information about **air quality, noise, public health and safety, energy consumption, population density, wildlife, vegetation, and need for sewer and water facilities**. Increasingly, these statements are also being required for private development.

### Disclosure of Environmental Hazards

State laws address the issue of disclosure of known material facts regarding a property's condition. These same rules apply to the presence of environmental hazards. **A real estate licensee may be liable if (s)he should have known about a condition, even if the seller neglected to disclose it.**

**NOTES:**

This image shows a full page of white paper with horizontal blue ruling lines. The lines are evenly spaced and run across the width of the page, providing a template for handwriting practice or general writing. There are no margins, text, or other markings on the page.

## CHAPTER 9: TITLE TRANSFER AND RECORDS

### MEANING OF TITLE

The term *title* has three meanings.

1. Title is a way of referring to ownership; it is not an actual printed piece of paper.
2. **Title to real estate** means the right to ownership or actual ownership of the land; it represents the **owner's bundle of rights**.
3. **Title also serves as evidence of that ownership** of real estate. **This is indicated by a deed, or a piece of paper.** A person who holds the title would, if challenged in court, be able to recover or retain ownership or possession of a parcel of real estate by providing the court with a copy of his or her deed.

Real Estate is **transferred** when the owner passes a deed to the new owner. It must be recorded to give public notice of new ownership.

**The Illinois Statute of Frauds** requires that any contracts for the sale of land, or for leases that are for more than one year from the date they are entered into, must be in writing to be enforceable in court.

### Requirements for a Valid Deed

The following are the minimum requirements for a valid deed in Illinois:

- *Grantor*, who has the legal capacity to execute (sign) the deed
- *Grantee* named with reasonable certainty to be identified
- Recital of *consideration*
- *Granting clause* (words of conveyance, together with any words of limitation)
- Accurate *legal description* of the property conveyed
- Any relevant *exceptions* or *reservations*
- *Signature of the grantor*, sometimes with a seal, witness, or acknowledgment
- *Delivery* of the deed and *acceptance* by the grantee to pass title

**Habendum clause** defines ownership taken by the grantee. The habendum clause begins with the words to *have and to hold*. Its provisions must agree with those stated in the granting clause. If there is a discrepancy, the granting clause prevails.

### Grantor

A grantor must be of lawful age, at least 18 years old. **A deed executed by a minor is usually voidable. A grantor also must be of sound mind.** Generally, any grantor who can understand the action is viewed as mentally capable of executing a valid deed. A deed executed by someone who was **mentally impaired at the time is voidable but not automatically void**. If, however, the **grantor has been judged legally incompetent, the deed will be void**. Real estate owned by someone who is legally incompetent can be conveyed only with a court's approval.

The **grantor's name must be spelled correctly and consistently throughout the deed**. If the grantor's name has been changed since the title was acquired, as **when a person changes her name by marriage, both names should be shown—for example, "Mary Smith, formerly Mary Jones."**

## Grantee

To be valid, a **deed must name a grantee**. The grantee must be specifically named so that the person to whom the property is being conveyed can be readily identified from the deed itself. **However, the grantee (new owner) is not required to sign the deed**.

**If more than one grantee is involved, the granting clause should specify their rights in the property.** The clause might state, for instance, that the grantees will take title as "**joint tenants**," "**tenants in common**," or "**tenants by the entirety**." This is especially important when specific wording is necessary to create a joint tenancy or tenancy by the entirety. The purchaser's or grantee's present address is required in Illinois as an element of a valid deed. Also, if no specific form of ownership is selected, tenancy in common is assumed in Illinois. One can determine, then, how ownership is held by consulting the deed language.

## Consideration

A valid deed must contain a clause **acknowledging that the grantor has received consideration, however the actual selling price is never contained in the deed**. Generally, the amount of consideration is stated in dollars. When a deed conveys real estate as a gift to a relative, "love and affection" may be sufficient consideration. In most states, however, it is customary to recite at least a *nominal consideration*, such as "\$10 and other good and valuable consideration."

**Granting clause (words of conveyance)** A deed must contain a granting clause that states the grantor's intention to convey the property. Depending on the type of deed and the obligations agreed to by the grantor (discussed later in this chapter), the wording would be similar to one of the following:

- "I, Kent Long, *convey and warrant*." (creates a warranty deed)
- "I, Kent Long, *remise, release, alienate, and convey...*" (creates a special warranty deed)
- "I, Kent Long, *grant, bargain, and sell...*" (creates a bargain and sale deed)
- "I, Kent Long, *remise, release, and quitclaim...*" (creates a quitclaim deed)

A deed that conveys the grantor's **entire fee simple absolute interest** usually contains wording such as "to ABC and to her *heirs and assigns forever*." If the grantor conveys **less than her complete interest**, such as a life estate, the wording must indicate this limitation—for example, "to ABC for the **duration of her natural life**."

## Legal description of real estate

To be valid, a deed must contain an **accurate legal description** of the real estate conveyed. Land is considered adequately described if a competent surveyor can locate the property using the description.

## Exceptions and Reservations

A valid deed must specifically note any encumbrances, reservations, or limitations that affect the title being conveyed. This might include such things as restrictions and easements that run with the land. In addition to citing existing encumbrances, a grantor may reserve some right to the land, such as an easement, for the grantor's use. A grantor may also place certain **restrictions on a grantee's use of the property**. Developers often restrict the number of houses that may be built on each lot in a subdivision. Such private restrictions must be stated in the deed or contained in a previously recorded document, such as the

subdivider's master deed, that is expressly referred to in the deed. Many of these deed restrictions have time limits and often include renewal clauses.

### Signature of Grantor

To be valid, a deed must be **signed by all grantors named in the deed**. Most states permit an **attorney-in-fact to sign for a grantor**. The attorney-in-fact must act **under a power of attorney**, the specific written authority to execute and sign one or more legal instruments for another person.

### Acknowledgment/notarization

An acknowledgment (also called notarization) is a formal declaration that the person who signs a written document does so voluntarily and that her signature is genuine. **In Illinois, acknowledgment/notarization is not essential to the validity of the deed.** However, unless the deed is acknowledged, it may not be introduced as evidence in a court of law without some further proof of its execution. As a result, it is customary that virtually all documents conveying title are acknowledged/notarized.

### Delivery and Acceptance

A title is not considered transferred until the deed is actually delivered to and accepted by the grantee. The grantor may deliver the deed to the grantee either personally or through a third party. In an arms-length transaction, the **title must be delivered during the grantor's lifetime and accepted during the grantee's lifetime**. The effective date of the transfer of title from the grantor to the grantee is the date of delivery of the deed itself. **When a deed is delivered in escrow, the date of delivery generally relates back to the date of deposit with the escrow agent.**

## EXECUTION OF CORPORATE DEEDS

The laws governing a corporation's right to convey real estate vary from state to state. However, two basic rules must be followed:

- A corporation can convey real estate only by authority granted in its bylaws or upon **resolution passed by its board of directors**. If all or a substantial portion of a corporation's real estate is being conveyed, a resolution authorizing the sale must usually be secured from the shareholders.
- Deeds to corporate real estate can be **signed only by an authorized officer**.

**A Deed** is a document that transfers real property while a **Bill of Sale** is used to transfer personal property.

### Types of Deeds

A deed can take several forms, depending on the extent of the grantor's pledges to the grantee. Regardless of any guarantees the deed offers, however, the grantee will want additional assurance that the grantor has the right to offer what the deed conveys. To obtain this protection, grantees commonly seek evidence of title.

The most common deed forms are:

- General warranty deed,
- Special warranty deed,
- Bargain and sale deed,
- Quitclaim deed,
- Deed in trust,
- Trustee's deed, and
- Deed executed pursuant to a court order.

### General warranty deed

A **general warranty deed provides the greatest protection of any deed**. It is called a general warranty deed because the grantor is legally bound by certain covenants or warranties (promises).

- **Covenant of seisin**—The grantor warrants that she owns the property and has the right to convey title to it. (*Seisin* simply means "possession.") The grantee may recover damages up to the full purchase price if this covenant is broken.
- **Covenant against encumbrances** —The grantor warrants that the property is free from liens or encumbrances, except for any specifically stated in the deed. Encumbrances generally include mortgages, mechanics' liens, and easements. If this covenant is breached, the grantee may sue for the cost of removing the encumbrances.
- **Covenant of quiet enjoyment**—The grantor guarantees that the grantee's title will be good against third parties who might bring court actions to establish superior title to the property. If the grantee's title is found to be inferior, the grantor is liable for damages.
- **Covenant of further assurance** —The grantor promises to obtain and deliver any instrument needed to make the title good. For example, if the grantor's spouse has failed to sign away dower rights, the grantor must deliver a quitclaim deed (discussed later) to clear the title.
- **Covenant of warranty forever** —The grantor promises to compensate the grantee for the loss sustained if the title fails at any time in the future.

Illinois law provides that a deed using the words "**convey and warrant**" implies and includes all covenants of general warranty, which are as binding on the grantor, his/her heirs, and personal representatives as if written at length in the deed. These covenants in a general warranty deed are not limited to matters that occurred during the time the grantor owned the property; they extend back to its origins. The grantor defends the title against herself and against all others as predecessors in title. In addition, it is sufficient for a general warranty deed to recite only nominal consideration.

### Special warranty deed

A special warranty deed contains two basic warranties:

1. Warranty that the grantor received title
2. Warranty that the property was not encumbered during the time the grantor held title, except as otherwise noted in the deed

In effect, the grantor defends the title against herself but **not against previous encumbrances**. The granting clause generally contains the words "grantor remises, releases, alienates, and conveys." The grantor may include additional warranties, but they must be specifically stated in the deed. In areas

where a special warranty deed is more commonly used, the purchase of title insurance is viewed as providing adequate protection to the grantee.

### **Bargain and sale deed**

In some states, a **bargain and sale deed** contains **no express warranties against encumbrances**. It does, however, imply that the grantor holds title and possession of the property.

The words in the granting clause are "grant, bargain, and sell." A grant, bargain, and sale deed conveys a simple title with the following covenants:

1. The grantor holds a fee simple estate,
2. The title is free from encumbrances made by the grantor except those listed in the deed, and
3. The grantor warrants quiet enjoyment.

**An Illinois bargain and sale deed is similar to a warranty deed but less complete in its warranties. The buyer should purchase title insurance for protection.**

### **Quitclaim deed**

A **quitclaim deed** provides the grantee with the least protection of any deed. It carries no covenants or warranties and generally **conveys only whatever interest the grantor may have when the deed is delivered. If the grantor has no interest, the grantee will acquire nothing.**

A quitclaim deed **can convey title as effectively as a warranty deed if the grantor has good title when she delivers the deed**, but it **provides none of the guarantees that a warranty deed does**. Through a quitclaim deed, the grantor only "remises, releases, and quitclaims" her interest in the property, if any. A quitclaim deed frequently is **used to cure a defect, called a *cloud on the title***; for example, if the name of the grantee is misspelled on a warranty deed filed with the Recorder of Deeds.

**In Illinois, a quitclaim deed uses the words "convey and quitclaim" and conveys in fee all the grantor's existing legal and equitable rights held at the time of delivery.**

### **Deed in trust**

A deed in trust is the means by which a **trustor conveys real estate to a trustee for the benefit of a beneficiary**. The real estate is held by the trustee to fulfill the purpose of the trust.

### **Trustee's deed**

**A deed executed by a trustee is a trustee's deed**. It is used when **a trustee conveys real estate held in the trust to the beneficiary**. The trustee's deed must state that the trustee is executing the instrument in accordance with the powers and authority granted by the trust instrument.

**Deed executed pursuant to court order Executors' and administrators' deeds, masters' deeds, sheriffs' deeds**, and many other types are all deeds executed pursuant to a court order. These deeds are established by state statute and are used to convey title to property that is **transferred by court order or by will**. The form of such a deed must conform to the laws of the state in which the property is located.



One common characteristic of deeds executed pursuant to court order is that the full consideration is usually stated in the deed. Instead of "\$10 and other valuable consideration," for example, the deed lists the actual sales price.

### **Transfer Tax Stamps**

The **Illinois Real Estate Transfer Act** imposes:

- A state tax on conveying title to real estate in the amount of \$0.50 per \$500, or fraction thereof
- In all Illinois counties, there is an additional transfer tax of \$0.25 per \$500, or fraction thereof
- Total transfer tax to state and county combined is \$0.75 per \$500 or fraction thereof.

**The transfer tax must be paid before the recording of the deed** (or before transferring the beneficial interest in a land trust). This is done by purchasing tax stamps from the county recorder or the city offices if there are local stamps required. These stamps are literally affixed to the deed.

### **Local transfer tax**

Many local municipalities have their own tax as well. Charts indicating these local transfer tax amounts are available from counties and individual municipalities. Local transfer tax can be paid by either buyer or seller, so it is important to check each municipality.

**The formula used in Illinois to determine the exact taxable consideration is as follows:**

- Full actual consideration (sales price)
- Less value of personal property included in purchase
- Less amount of mortgage to which property remains subject
- Equals net TOTAL taxable consideration to be covered by stamps
- Amount of Illinois state tax stamps (\$.50 per \$500 or taxable amount)
- Amount of county tax (\$.25 per \$500)
- Total transfer tax

### **Real Estate Transfer Declaration**

In Illinois, the sale price must be shown on the Real Estate Transfer Declaration form. The form must be signed by the buyer and seller or their agents, and it provides for the inclusion of the property description, manner of conveyance, and type of financing used. The financing data helps the Department of Revenue accurately determine equalization factors between different counties and eliminate inconsistencies caused by the use of nonconventional or creative financing.

**A completed declaration must accompany every deed presented to the recorder for recording.** (The Cook County Recorder's office has its own separate transfer form, which also must be presented with every deed). The information contained on the form is not confidential and is available for inspection by the public.

Exempted from the transfer tax are:

- Deeds such as those conveying real estate from or between any governmental bodies,
- Those held by charitable, religious, or educational institutions,

- Those securing debts or releasing property as security for a debt,
- Partitions,
- Tax deeds,
- Deeds pursuant to mergers of corporations,
- Deeds from subsidiary to parent corporations for cancellation of stock,
- Deeds subject to federal documentary stamp tax.

When the actual consideration for conveyance is less than \$100, the transfer is considered a gift and is exempt from tax. An exemption statement is usually typed on an exempted deed and signed before the deed is recorded.

### **Tax stamps and land trusts**

Under the **Land Trust Recordation and Transfer Tax Act**, a land trustee has the obligation to record a facsimile of the assignment of beneficial interest. The names of the beneficiaries need not be disclosed, and privacy is maintained. The transfer tax rate and the exemptions are the same for the assignment as for the transfer of real property.

### **INVOLUNTARY ALIENATION**

Title to property may be transferred without the owner's consent by involuntary alienation. Involuntary transfers are usually carried out by operation of law such as by condemnation or a sale to satisfy delinquent tax or mortgage liens. When a person dies intestate (without a will) and leaves no heirs, the title to the real estate passes to the county (in Illinois) by the state's power of escheat. Additional land may be acquired through the process of accretion or lost through erosion, and other acts of nature, such as earthquakes, hurricanes, sinkholes, and mudslides, may add to or eliminate a landowner's holdings.

### **Transfer by Adverse Possession**

Adverse possession, sometimes referred to as squatter's rights, is another means of involuntary transfer. An individual who makes a claim to certain property, takes possession of, and uses it may take title away from an owner who fails to use or inspect the property for a period of years. The law recognizes that the use of land is an important function of its ownership. Usually, the possession by the claimant must be:

- Open,
- Notorious,
- Continuous and uninterrupted,
- Hostile, and
- Adverse to the true owner's possession.

**The period of uninterrupted possession required to claim title by adverse possession is 20 years.** However, if the party whose property is being claimed has *color of title* (that is, if the apparently good title actually is invalidated by some flaw) and if the **real estate taxes on the property are paid** while satisfying the other statutory requirements, the possessory period may be shortened to **seven years**.

**Tacking on** - Through the principle of tacking, **successive periods of different adverse possession by different adverse possessors can be combined**, enabling a person who is not in possession for the entire required time to establish a claim.

### **Transfer of Property Through a Will**

A person who dies testate (with a will) has prepared a will indicating how his/her property should be handled.

### **Transfer of Property After Death — No Will**

In contrast, when a person dies intestate (without a will), real estate and personal property pass to the decedent's heirs **according to the state's statute of *descent and distribution***. In effect, the state provides a will for an intestate decedent.

In Illinois, when the owner of real estate dies, how title to the property was held (rather than the laws of descent and distribution or the presence of a will) may dictate who the new owners will be:

- If the property was owned by a **husband and wife in tenancy by the entirety** or was held in **joint tenancy**, the **surviving spouse (or another owner) will automatically be the new owner**. If the property was held as a **life estate**, it automatically **reverts to the former owner or passes to a remainderman**. In these cases, **no probate is required**.
- If the property was not held in joint tenancy, tenancy by the entirety, or as a life estate, and the owner **left a valid will (died testate)**, the **devisees named in the will own the real estate**.
- If the owner died **without a will (intestate)**, **relatives would inherit the property** according to the **Illinois Law of Descent**. (In effect, the state makes a will for such decedents).
- If the owner died **without a will (intestate) and left no heirs**, the real property will **escheat to the Illinois county it lies in**.

### **Transfer of Title by Will**

A will is an instrument made by an owner to **convey title to real or personal property after the owner's death**. A will is a testamentary instrument; that is, it **takes effect only after death**. This **differs from a deed, which must be delivered during the lifetime of the grantor** and conveys a present interest in property.

While the testator (the person who makes a will) is alive, **any property included in the will can still be conveyed by the owner**. The parties named in a will have **no rights or interests as long as the party who made the will lives**, they acquire interest or title only after the owner's death. **Only property owned by the testator at the time of death may be transferred by will.**

The gift of **real property** by will is known as a **devise**, and a person who receives property by will is known as a **devisee**.

The gift of **personal property** by will is known as a **legacy** or a **bequest**, and a person who receives the personal property by will is known as a legatee or **beneficiary**.

## Probate

Legally, when a person dies, ownership of real estate immediately passes either to the heirs by descent or to the persons named in the will. Before these individuals can take full title and possession of the property, however, the estate must go through probate and claims against the estate must be satisfied. For title to pass to the devisee(s), state laws require that upon the death of a testator, the will must be **filed with the court and probated. Probate is a legal procedure for verifying the validity of a will and accounting for the decedent's assets.** The process can take several months to complete.

Upon the death of a testator, the will must be filed and a petition for probate initiated in the circuit court of the county in which the decedent resided. For six months after the executor has been appointed and the decedent's property has been inventoried, claims may be presented to the executor for debts owed by the deceased. **On completion of probate, the executor's final account is filed with the court and the executor is discharged. The real estate is considered free from debts, claims, or taxes of the decedent.**

## Probate Proceedings

Probate is a formal judicial process that:

- proves or confirms the validity of a will,
- determines the precise assets of the deceased person, and
- identifies the persons to whom the assets are to pass.

**The purpose of probate is to see that the assets are distributed correctly.** All assets must be accounted for, and the decedent's debts must be satisfied before any property is distributed to the heirs. In addition, estate taxes must be paid before any distribution. Any probate proceedings will take place in the county in which the decedent resided. **If the decedent owned real estate in another county, probate would occur in that county as well.**

## Legal requirements for making a will

Any person **18 or older, who is of sound mind and memory, may make a will.** A will must be in writing and signed and declared by the maker (the *testator*) in the presence of two or more witnesses to be her last will and testament. **Witnesses cannot be beneficiaries under the will** because their gifts will likely be voided by the probate court.

A **codicil** is a modification of an amendment of, or an addition to a previously executed will and may be set forth in a separate document.

A **holographic will** is written in the testator's own handwriting. A **nuncupative will**, such as a deathbed bequest, is given **orally** by a testator and is for personal property.

**Illinois courts do not recognize holographic wills or nuncupative wills unless also witnessed by two people in each case.**

**In Illinois, while an individual may freely disinherit children or other previously named heirs, a surviving spouse may not be disinherited by the decedent spouse.** A surviving spouse who is

disinherited by the decedent has a statutory right to renounce the will and claim a share of the estate as follows:

- If the deceased left **no child or descendant(s) of a child**, **one-half of the personal estate and one-half of each parcel of real estate** goes to the **spouse** if claimed.
- If the deceased left **spouse and descendants**, **one-third of the personal estate and one-third of each parcel of real estate** go to the **spouse** if claimed.
- The will remains operative with respect to the balance of the estate.

### **Transfer of Title by Descent**

When a person dies **intestate (without leaving a valid will)**, her state's law of descent governs how and to whom her property will be distributed.

**The Illinois Law of Descent and Distribution (in the Illinois Probate Act) provides that real estate located in Illinois owned by a deceased resident or nonresident who did not leave a valid will is distributed as follows:**

- Spouse, no children — Spouse gets 100%
- Spouse, children — Spouse gets 50%, children get equal shares of the remaining 50%. If a child is dead, then the children (grandchildren of the dead spouse) get the dead mother's or father's share.
- No Spouse, No children — Family members (father, mother, brothers, sisters of the dead spouse) get equal shares. If a father or mother of the spouse is dead, the surviving spouse gets the dead mother's or father's share. If both parents of the dead spouse are also dead, the brothers and sisters get equal shares.
- No Spouse, No Children, No immediate Family Members — surviving relatives inherit the dead spouse's property.
- No heirs — property escheats to the county in which the property is located.

**The estate of an intestate decedent must be probated to determine which statutory heirs will inherit. As well as to inventory the assets of and claims against the estate.** Any heir or another interested person may petition the circuit court of the county in which the decedent last resided to probate the estate. Proof of heirship must be presented to the court. Probate generally proceeds as if the decedent had left a valid will. Once the heirs have been determined, the court appoints an *administrator* or a personal representative to administer the affairs of the estate the role usually taken by an executor. Once all obligations have been satisfied, the representative **distributes the remaining property according to the terms of the will or the state's law of descent.**

### **REAL ESTATE DOCUMENTS - PUBLIC RECORDS**

**Public records contain detailed information about each parcel of real estate in a city or county.** These records are crucial in establishing ownership, giving notice of encumbrances, and establishing priority of liens. They protect the interests of real estate owners, taxing bodies, creditors, and the general public. The **real estate recording system includes written documents that affect title, such as deeds and mortgages.**

Public records are maintained by:

- Recorders of deeds,
- County clerks,
- County treasurers,
- City clerks,
- Collectors, and clerks of court.

**In Illinois, the recorder of deeds, county clerk, county treasurer, city clerk and collector, and clerks of various courts maintain these records.**

**Public records are just that: open to the public.** This means that **anyone interested in a particular property can review the records** to learn about the documents, claims, and other issues that affect its ownership. A prospective purchaser, for example, needs to be sure that the seller can convey title to the property. If the property is subject to any liens or other encumbrances, a prospective buyer or lender will want to know.

## **Recording**

**Recording is the act of placing documents in the public record.** Any written document that affects any estate, right, title, or interest in land must be **recorded in the county where the land is located** to serve as public notice. That way, anyone interested in the title to a parcel of property will know where to look to discover the various interests of all other parties. **Illinois law does not require that most documents be filed or recorded within a specified period of time.**

**In Illinois, however, when creditors and subsequent purchasers do not actually know the content of the documents affecting certain real estate interests, the courts will hold these creditors and purchasers responsible for "discovering" (knowing) that information only as of the date on which the documents are recorded.**

**Tax deeds, by Illinois law, must be recorded within one year after the redemption period expires.** A tax deed that is not recorded or filed within one year becomes **null and void.**

**As a matter of Illinois law, no instrument affecting title to real property may include any provision prohibiting recording. Any such prohibiting provision is void.**

The original document must be filed with the county recorder of deeds and must meet specific requirements (in addition to the nine requirements of a valid deed):

- Grantor's name typed or printed below his signature
- Full address of the grantee
- Name and address of the person who prepared the deed
- Permanent tax index number (required only in some counties)
- Common address of the property (required only in some counties)
- Completed real estate transfer declaration
- Proof of payment of the state and county transfer taxes or indication of an applicable exemption
- Proof of payment of the municipal transfer tax (if applicable)

A deed in any language other than English, although valid between the parties, does not give constructive notice **unless an official English translation of the document is attached at the time of recording**. The translation must be prepared by a credible source, such as the local consulate of a country in which the language is used.

### **Constructive Notice**

This is the legal presumption that information may be **obtained by an individual through due diligence — consulting the public documents**. Properly **recording documents** in the public record serves as **constructive notice** to the world of an individual's rights or interest, as does the physical possession of a property. Because the information or evidence is readily available to the world, a prospective purchaser or lender is responsible for discovering the interest.

### **Actual Notice**

This means not only that the information is available but also that someone has been given the **information and actually knows it**. An individual who has searched the public records and **inspected the property has actual notice** (buyer does this when he or she tours the property when looking at properties and shortly before closing), also known as *direct knowledge*. If it can be proved that an individual has had actual notice of information, that person cannot use a lack of constructive notice (such as an unrecorded deed) to justify a claim.

**Constructive Notice** - could or should know with reasonable inquiry

**Actual Notice** - knows for certain by personal service

### **Priority**

**Priority** refers to the **order of rights in time**. Many complicated situations can affect the priority of rights in a parcel of real estate - who recorded first, which party was in possession first, who had actual or constructive notice. How the courts rule in any situation depends, of course, on the specific facts of the case. These are strictly legal questions that should be referred to the parties' attorneys.

### **Unrecorded Documents**

Certain types of liens are not recorded. **Real estate taxes and special assessments are liens on specific parcels of real estate and usually are not recorded at the time they become effective (January 1 each year for Illinois Real Estate Taxes)**, until sometime after the taxes or assessments are past due. Inheritance taxes and franchise taxes are statutory liens. They are placed against all real estate owned by a decedent at the time of death or by a corporation at the time the franchise taxes became a lien. Like real estate taxes, they are not recorded.

**In Illinois, a mechanic's lien that has not been recorded may nonetheless still have priority over other liens that have been recorded.**

## Chain of Title

A chain of title is the **record of a property's ownership**. Beginning with the earliest owner, title may pass to many individuals. Each owner is linked to the next so that a chain is formed. An unbroken chain of title can be traced through linking conveyances from the present owner back to the earliest recorded owner. Chain of title does not include liens and encumbrances or any other document not directly related to ownership.

If ownership cannot be traced through an unbroken chain, a gap or cloud in the chain of title is said to exist. In these cases, the cloud on the title makes it necessary to establish ownership by a court action called a **suit to quiet title**. Often, the simple procedure of obtaining any relevant quitclaim deeds is used to clear title and establish ownership.

## Title Search and Abstract of Title

A **title search is an examination of all of the public records to determine whether any defects exist in the chain of title**. The records of the conveyances of ownership are examined, beginning with the present owner. Normally, the root is considered to be 40 years. Under most circumstances, then, it is necessary to search only from the current owner to the root.

For normal title searches in Illinois, the search goes back 40 years under the **Illinois Marketable Title Act**. When the possibility of litigation exists, the search must go back 75 years. A title search usually is not ordered until after the major contingencies in a sales contract have been cleared, for instance, after a loan commitment has been secured. Before providing money for a loan, a lender or the attorney orders a title search to ensure that no lien is superior to its mortgage lien. In most cases, the cost of the title search in Illinois is paid by the seller.

**An abstract of title is** a summary giving details of the title deeds and documents that prove an owner's right to dispose of land, together with any encumbrances that relate to the property. The person who prepares this report is called an *abstractor*. The abstractor searches all the public records and then summarizes the various events and proceedings that affected the title throughout its history. The report begins with the original grant (or root), then provides a chronological list of recorded instruments. All recorded liens and encumbrances are included, along with their current statuses. A list of all of the public records examined is also provided as evidence of the scope of the search.

## Marketable Title

Under the terms of the typical real estate sales contract, the seller is required to deliver marketable title to the buyer at the closing. To be marketable, a title must:

- disclose no serious defects and not depend on doubtful questions of law or fact to prove its validity,
- not expose a purchaser to the hazard of litigation or threaten the *quiet enjoyment* of the property, and
- convince a reasonably well-informed and prudent purchaser, acting on business principles and with knowledge of the facts and their legal significance, that he could sell or mortgage the property at a later time.



Although a title that does not meet these requirements still could be transferred, it contains certain defects that may limit or restrict its ownership. A buyer cannot be forced to accept a conveyance that is materially different from the one bargained for in the sales contract. However, **questions** of marketable title must be raised by a buyer **before acceptance** of the deed. **Once a buyer has accepted a deed with an unmarketable title, the only available legal recourse is to sue the seller under any covenants of warranty contained in the deed.**

### PROOF (ASSURANCE) OF OWNERSHIP

Proof of ownership is evidence that title is marketable. A **deed by itself is not considered sufficient evidence of ownership in Illinois**. Even though a warranty deed conveys the grantor's interest, it contains no proof of the condition of the grantor's title at the time of the conveyance. The **grantee needs some assurance** that (s)he actually is acquiring ownership and that the title is marketable.

### Certificate of Title

A **certificate of title** is a **statement of opinion** regarding **title status** on the date the certificate is issued. A certificate of title is **not a full guarantee of ownership**. Rather, it certifies the condition of the title's history based on an actual examination of the public records - a title search. The certificate may be prepared by a title company, a licensed abstractor, or an attorney. An owner, a mortgage lender, or a buyer may request the certificate.

**Although a certificate of title is used as evidence of ownership, it is not perfect**. Unrecorded liens or rights of parties in possession cannot be discovered by a search of the public records. Hidden defects, such as transfers involving forged documents, incorrect marital information, incompetent parties, minors, or fraud cannot be detected. **A certificate offers no defense against these defects because they are unknown**. The person who prepares the certificate is **liable only for negligence in preparing the certificate**.

### Abstract and Attorney's Opinion of Title

An **abstract and attorney's opinion of title** are used in some areas, including Illinois, as evidence of title. This is an **opinion of title status** based on a review of the abstract by an attorney. Similar to a certificate of title, the **opinion of title does not protect against defects** that cannot be discovered from the public records. Many buyers purchase title insurance to defend the title from these defects.

### Title Insurance

**Title insurance** is a contract (Insurance Policy) under which the policyholder (Buyer) is **protected from losses arising from defects in the title**. A title insurance company determines whether the title is insurable based on a review of the public records. If so, a policy is issued. Unlike other insurance policies that insure against future losses, **title insurance protects the insured from an event that occurred before the policy was issued**. Title insurance is considered the **best defense (Assurance) of title, since the title insurance company will defend any lawsuit based on an insurable defect and pay claims if the title proves to be defective**.

After examining the public records, the title company usually issues what may be called a *preliminary report of title* or a *commitment to issue a title policy*. This describes the type of policy that will be issued and includes:

- the name of the insured party,
- the legal description of the real estate,
- the estate or interest covered,
- conditions and stipulations under which the policy is issued, and
- a schedule of all exceptions, including encumbrances and defects found in the public records and any known unrecorded defects.

**The premium for the policy is paid once, at closing.** The maximum loss for which the company may be liable cannot exceed the face amount of the policy. When a title company makes a payment to settle a claim covered by a policy, the company generally acquires the right to any remedy or damages available to the insured. **This right is called subrogation.** An exception or defect noted in the title commitment may be waived or endorsed by the title company with the submission of credible supporting evidence. The title company may charge additional fees for the waiver or endorsement.

**A title insurance policy is the most commonly used evidence (Assurance) that an owner of Illinois real property tenders to a prospective purchaser or lender as proof of good title in order to induce the buyer to purchase the property.** Careful listing agents often request a copy of the first page of a title insurance policy for their files so as to be certain those selling a property have the right to do so. **The Illinois Title Insurance Act** requires that parties to a "contract for the sale of residential real property who are obligated to provide and pay for title insurance have the right to choose the title insurance company and title insurance agent that will provide the title insurance."

"No lender or producer of title business, as a condition of making the loan or providing services of any kind, require a party to a residential sales contract and who is obligated by that contract to furnish and pay for title insurance at their expense, to procure title insurance from a title insurance company that is not chosen by the party paying for the insurance." **Statute ILCS 155/3**

### **Owner's Title Insurance Policy Coverage**

Exactly which defects the title company will defend depends on the type of policy. A *standard coverage policy* normally insures the title as it is known from the public records. In addition, the standard policy insures against such **hidden defects as forged documents, conveyances by incompetent grantors, incorrect marital statements, and improperly delivered deeds.**

**Extended coverage, as provided by an American Land Title Association (ALTA) policy,** includes the protections of a standard policy plus additional protections. **Most lenders require extended coverage title policies.** An extended or ALTA policy **protects a homeowner against defects that may be discovered by inspection of the property (i.e., rights of parties in possession, examination of a survey, and certain unrecorded liens).** An extended title insurance policy would offer the buyer protection against **secret liens, such as unrecorded mechanics' liens, and also is required by most lenders.**

Title insurance does not offer guaranteed protection against all defects. A title company will not insure a bad title or offer protection against defects that clearly appear in a title search. The policy generally names certain uninsurable losses, called **exclusions**. These include **zoning ordinances, restrictive covenants, easements, certain water rights, and current taxes and special assessments**.

### **Lender's (Buyer's) Title Insurance Policy**

A lender's policy is issued for the benefit of the mortgage company. This policy is usually **paid for by the buyer** at the closing. The amount of the coverage depends on the amount of the mortgage loan. **As the loan balance is reduced, the coverage decreases.**

**NOTES:**

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

## CHAPTER 10: REAL ESTATE CLOSINGS

### PRECLOSING PROCEDURES

#### Buyer's Requirements to Close

Both the buyers and their lenders must be sure that the seller can deliver the title that was promised in the purchase agreement and that the property is now in essentially the same condition it was in when the buyers and the sellers agreed to the sale. This involves inspecting:

- the title evidence,
- the seller's deed,
- any documents demonstrating the removal of undesired liens and encumbrances,
- the survey,
- the results of any required inspections, such as termite or structural inspections, or required repairs, and
- any leases if tenants reside on the premises.

#### Final property inspection

In the real estate contract, the **buyer usually reserves the right to make a final inspection**, often referred to as a walk-through, shortly before the closing takes place. Accompanied by the licensee, the buyer verifies that necessary repairs have been made, that the property has been well maintained, that all fixtures are in place, and that no unauthorized removal or alteration of any part of the improvements has taken place. It is not an opportunity to reopen negotiations.

#### Spot Survey

A spot survey provides information about the **exact location and size of the property boundaries**, as well as the **location of all the improvements on the property**. The spot survey will reveal any encroachments and easements. The sales contract specifies who will pay for the survey. Typically, the survey indicates the location of all buildings, driveways, fences, and other improvements located on the premises.

#### Seller's Requirements to Close

Naturally, the seller's main interest is to receive payment for the property. Sellers want to be sure that:

- the buyer has obtained the necessary financing
- has sufficient funds to complete the sale.
- are certain that they have complied with all the buyer's requirements.

#### Title Procedures

Both the buyer and the buyer's lender will want assurance that the seller's title complies with the requirements of the sales contract (Seller's Title insurance Policy, with the Buyer named as Beneficiary). Additionally, lenders require title insurance in the event any "clouds" on the title (encumbrances on the real estate or claims on the title) should come up during the course of ownership (Lender's or Buyer's Title Insurance Policy, with the Lender named as Beneficiary).

As a first step toward a new owner's title policy, prior to closing and establishment of the new owner's title, the seller usually is required to produce a **current abstract of title or title commitment from the title**

**insurance company.** When an abstract of title is used, the **purchaser's attorney examines it and issues an opinion of title.** This opinion, like the title commitment, is a statement of the status of the seller's title. It discloses all liens, encumbrances, easements, conditions, or restrictions that appear on the record and to which the seller's title is subject.

On the date when the sale is actually completed (the date of delivery of the deed), the buyer has a title commitment or an **abstract that was issued several days or weeks before the closing.** For this reason, there usually are two searches of the public records. The **first shows the status of the seller's title on the date of the first search.** Usually, the seller pays for this search. The **second search,** known as a ***bring-down***, is made after the closing to bring the title search down to the day of closing.

### **Affidavit of Title**

As part of this later search, the seller may be required to execute an ***affidavit of title.*** This is a sworn statement in which the seller assures the title insurance company (and the buyer) that there have been **no judgments, bankruptcies, or divorces involving the seller since the date of the first title examination.**

The affidavit promises that **no unrecorded deeds or contracts have been made, no repairs or improvements have gone unpaid, and no defects in the title have arisen that the seller knows of.** The affidavit gives the title insurance company the right to sue the seller if his statements in the affidavit are incorrect.

In 2010, the Title Insurance Act was amended by prohibiting title insurance companies, title insurance agents or independent escrowees from making disbursements out of a fiduciary trust account in connection with any escrows, settlements, or closings **unless the funds are collected or are good funds.** This applies to \$50,000 or less from any single party to a transaction or an aggregate amount of \$50,000 or greater received from any single party to a transaction.

"Good funds" are in one of the following forms:

- Lawful money of the United States
- Wired funds unconditionally held by the title insurance company, the title insurance agent, or independent escrowee
- Cashier's checks, certified checks, bank money orders, official bank checks, or teller's checks drawn on or issued by a financial institution chartered under the laws of any state of the United States and unconditionally held by the title insurance company, title insurance agent, or independent escrowee
- A personal check or checks in an aggregate amount not exceeding \$5,000 per closing, provided that the title insurance company, title insurance agent, or independent escrowee has reasonable grounds to believe that sufficient funds are available for withdrawal in the account upon which the check is drawn at the time of disbursement
- A check drawn on the trust account of any lawyer or real estate broker licensed under the laws of any state, provided that the title insurance company, title insurance agent, or independent escrowee has reasonable grounds to believe that sufficient funds are available for withdrawal in the account upon which the check is drawn at the time of disbursement

- A check issued by Illinois or the United States
- A check drawn on the fiduciary trust account of a title insurance company or title insurance agent, provided that the title insurance company, title insurance agent, or independent escrowee has reasonable grounds to believe that sufficient funds are available for withdrawal in the account upon which the check is drawn at the time of disbursement

*Collected funds* means funds deposited, finally settled, and credited to the title insurance company, title insurance agent, or independent escrowee's fiduciary trust account.

**Whether the purchaser pays cash or obtains a new loan to purchase the property, the seller's existing loan is paid in full and satisfied on record.** The exact amount required to pay the existing loan is provided in a **current payoff statement** from the lender, effective on the date of closing.

## CLOSING PROCEDURES

### Face-to-Face Closing

*Face-to-face* closings may be held at a number of locations, including the offices of the title company, the lending institution, an attorney for one of the parties, the broker, the county recorder, or the escrow company. Those attending a closing may include:

- the buyer or the buyer's duly authorized agent,
- the seller or the seller's duly authorized agent,
- the real estate licensees (both the buyer's and the seller's agents),
- the seller's and the buyer's attorneys,
- representatives of the lending institutions involved with the buyer's new mortgage loan, the buyer's assumption of the seller's existing loan, or the seller's payoff of an existing loan; and
- a representative of the title insurance company

### Closing agent or closing officer

A closing agent may be a representative of the title company, the lender, the real estate broker, or the buyer's or seller's attorney. Some title companies and law firms employ paralegal assistants who conduct closings for their firms.

**The closing agent orders and reviews the title insurance policy or title certificate, surveys, property insurance policies, and other items.** After reviewing the agreement of sale (purchase agreement), the agent **prepares a closing statement indicating the division of income and expenses between the parties.** Finally, the time and place of closing must be arranged.

### The exchange

When the parties are satisfied that everything is in order, the exchange is made. The seller delivers the signed deed to the buyer, who in return, provides the seller with the funds from the buyer's loan and the buyer's down payment. All pertinent documents are then recorded in the correct order to ensure continuity of title. The buyer's new mortgage or deed of trust must be recorded *after* the deed because the buyer cannot pledge the property as security for the loan until he owns it.

## Closing in Escrow (Non-Face-to-Face Closing)

An escrow is a method of non-face-to-face closing in which a **disinterested third party is authorized to act as escrow agent and to coordinate the closing activities**. The escrow agent also may be called the **escrow holder**. The escrow agent may be an attorney, a title company, a trust company, an escrow company, or the escrow department of a lending institution.

## Escrow Closing Procedure

When a transaction will close in escrow, the **buyer and seller execute escrow instructions** to the escrow agent after the sales contract is signed. One of the parties selects an escrow agent. Which party selects the agent is determined either by negotiation or by state law. Once the contract is signed, the broker turns over the earnest money to the escrow agent, who deposits it in a special trust, or escrow, account.

Buyer and seller deposit all pertinent documents and other items with the escrow agent before the specified date of closing.

The **seller** usually deposits:

- the deed conveying the property to the buyer,
- title evidence - abstract and attorney's opinion of title, certificate of title, title insurance
- existing hazard insurance policies,
- a letter or mortgage reduction certificate from the lender stating the exact principal remaining (if the buyer assumes the seller's loan),
- affidavits of title (if required),
- a payoff statement (if the seller's loan is to be paid off),
- bill of sale,
- survey,
- transfer tax declarations,
- paid water bill, and
- other instruments or documents necessary to clear the title or to complete the transaction.

The **buyer** deposits:

- the balance of the cash needed to complete the purchase, usually in the form of a certified check,
- loan documents (if the buyer secures a new loan),
- proof of hazard insurance and flood insurance (if required), and
- other necessary documents, such as inspection reports required by the lender.

The escrow agent has the authority to examine the title evidence. When marketable title is shown in the name of the buyer and all other conditions of the escrow agreement have been met, the **agent is authorized to disburse the purchase price to the seller, minus all charges and expenses**. The agent then records the deed and mortgage or deed of trust (if a new loan has been obtained by the purchaser).



If the escrow agent's examination of the title discloses liens, a portion of the purchase price can be withheld from the seller. The withheld portion is used to pay the liens to clear the title.

If the **seller cannot clear the title**, or if for any reason the sale cannot be consummated, the escrow instructions usually provide that **the parties be returned to their former statuses as if no sale occurred**. The escrow agent re-conveys title to the seller and returns the purchase money to the buyer. If the seller dies prior to the closing date, but after having given a signed deed to the escrow agent, the closing still may proceed, with the escrow agent transferring title to the buyer and turning the purchase price over to the seller's estate.

## IRS Reporting Requirements

Certain real estate closings must be reported to the Internal Revenue Service (IRS) on Form 1099-S.

The affected properties include sales or exchanges of:

- land (improved or unimproved), including air space,
- an inherently permanent structure, including any residential, commercial, or industrial building,
- a condominium unit and its appurtenant fixtures and common elements including land),
- shares in a cooperative housing corporation.

Information to be reported includes:

- the sales price,
- the amount of property tax reimbursement credited to the seller,
- the seller's Social Security number.

If the closing agent does not notify the IRS, the responsibility for filing the form falls on the mortgage lender, although the real estate licensees or the parties to the transaction ultimately could be held liable.

## Licensee's Role at Face-to-Face Closings

In Illinois, the Licensee's role is limited to simply collecting the commission. A licensee's job is essentially finished as soon as the sales contract is signed. After the contract is signed, the attorneys take over. Even so, **a licensee's service generally continues all the way through closing** because it is in the licensee's best interest that the transactions move successfully and smoothly to a conclusion. This may mean actively arranging for title evidence, surveys, appraisals, and inspections or repairs for structural conditions, water supplies, sewage facilities, or toxic substances.

Real estate licensees usually attend the face-to-face closing. Often, the parties look to their agents for guidance, assistance, and information during what can be a stressful experience.

Licensees should avoid recommending sources for any inspection or testing services. If a buyer suffers any injury as a result of a provider's negligence, the licensee might also be named in any lawsuit. The better practice is to give clients the names of several professionals who offer high-quality services. In addition, licensees who receive any compensation or reward from a source they recommend to a client

**must disclose such an arrangement to the client. Licensees must never receive compensation from an attorney or a lender.**

### **Lender's Interest at Closing**

Whether a buyer obtains new financing or assumes the seller's existing loan, the **lender wants to protect its security interest in the property**. The lender has an interest in making sure the buyer gets good, marketable title and that tax and insurance payments are maintained. Lenders want their mortgage lien to have priority over other liens. They also want to ensure that insurance is kept up to date in case property is damaged or destroyed.

**As a result, the buyer must also provide a fire and hazard insurance policy (along with a receipt for the premium) at closing, effective as of the date of closing. A lender usually requests that a reserve account be established for tax and insurance payments so that these payments are maintained.**

### **REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)**

The **Real Estate Settlement Procedures Act (RESPA)** is a **federal consumer law that requires certain disclosures about the mortgage and settlement process and prohibits certain practices that increase the costs of settlement services, such as kickbacks and referral fees that can increase settlement costs for home buyers.**

**RESPA regulations apply to first lien residential mortgage loans made to finance the purchases of one to four-family homes, cooperatives, and condominiums, for either investment or occupancy**, as well as second or subordinate liens for home equity loans when a purchase is financed by a federally related mortgage loan. Federally related loans are those made by banks, savings and loan associations, or other lenders whose deposits are insured by federal agencies; loans insured by the FHA and guaranteed by the Department of Veterans Affairs (VA); loans administered by HUD; and loans intended to be sold by the lenders to Fannie Mae, Ginnie Mae, or Freddie Mac.

### **RESPA does not apply to the following settlements:**

- Loans on large properties (i.e., more than 25 acres)
- Loans for business or agricultural purposes
- Construction loans or other temporary financing
- Loans for business or agricultural purposes
- Construction loans or other temporary financing
- Vacant land (unless a dwelling will be placed on the lot within two years)
- A transaction financed solely by a purchase-money mortgage taken back by the seller
- An installment contract (contract for deed)
- A buyer's assumption of a seller's existing loan (If the terms of the assumed loan are modified, or if the lender charges more than \$50 for the assumption, the transaction is subject to RESPA regulations).

RESPA prohibits certain practices that increase the cost of settlement services:

- Section 8 **prohibits kickbacks and fee-splitting for referrals of settlement services and unearned fees for services not actually performed.** Violations are subject to criminal and civil penalties, including fines up to \$10,000 and/or imprisonment for up to one year. Consumers may privately pursue a violator in court; the violator may be liable for an amount up to three times the amount of the charge paid for the service.
- Section 9 **prohibits home sellers from requiring that homebuyers buy title insurance from a particular company.** Buyers may sue the seller for such a violation; violators are liable for up to three times the amount of all charges paid for the title insurance.
- Section 10 **prohibits lenders from requiring excessive escrow account deposits,** money set aside to pay taxes, hazard insurance, and other charges related to the property.

### In Practice

Although RESPA's requirements are aimed primarily at lenders, real estate licensees fall under RESPA when they refer buyers to particular lenders, title companies, attorneys, or other providers of settlement services. Licensees who offer computerized loan origination (CLO) are also subject to regulation. Remember that buyers have the right to select their own providers of settlements services.

### Affiliated Business Arrangement

To streamline the settlement process, a real estate firm, title insurance company, mortgage broker, home inspection company, or even a moving company may agree to offer a package of services to consumers, a system known as an **affiliated business arrangement (ABA)**.

**RESPA permits an ABA as long as:**

- A consumer is clearly informed of the relationship among the service providers,
- That participation is not required,
- That other providers are available,
- That the only thing of value received by one business entity from others, in addition to permitted payments for services provided, is a return on ownership interest or franchise relationship.

**Fees must be reasonably related to the value of the services provided and not be fees exchanged among the affiliated companies simply for referring business to one another.** This referral-fee prohibition may be a particularly important issue for licensees who offer computerized loan origination (CLO) services to their clients and customers. CLOs that provide services to consumers may charge for the services provided; the fees must be disclosed on the HUD-1 or HUD 1A settlement statement. While a borrower's ability to comparison shop for a loan may be enhanced by a CLO system, **the range of choices must not be limited.** Consumers must be informed of the availability and costs of other lenders.

### Disclosure Requirements

Lenders and settlement agents have the **following disclosure obligations at the time of loan application and loan closing or within three business days of receiving the loan application.** If

the lender denies the loan within three days, then RESPA does not require that the lender provide the following documents:

### **Special information booklet**

This HUD booklet, which must be given at the time of application or provided within three days of loan application, provides the borrower with general information about settlement (closing) costs. It also explains the various provisions of RESPA, including a line-by-line description of the Uniform Settlement Statement.

### **Good Faith Estimate of Lending Costs**

Summary of base interest, term, down payment, loan origination fee, points, discount points, credit report, and any other miscellaneous costs. **Issuing a new GFE triggers a new three-day waiting period; in which case, closing may not occur until after three days have passed.**

The GFE indicates which closing costs may or may not change prior to settlement and, if they do, by how much. The fees are divided into three categories:

- **No tolerance**—fees that may not increase before closing:
  - Lender charges for taking, underwriting, and processing the loan application,
  - Including points,
  - Origination fees, and
  - Yield spread premiums
- **10 percent tolerance**—fees that cannot increase by more than 10 percent in any given category:
  - Settlement services for which the lender selects the provider or for which the borrower selects the provider from the lender's list,
  - Title services and title insurance if the lender selects the provider, and recording fees
- **Unlimited tolerance**—fees for services that are out of the lender's control: services for which the borrower chooses the provider:
  - Such as escrow charges
  - Title insurance fees
  - Impounds for taxes, mortgage interest
  - The cost of homeowners' insurance

**Mortgage servicing disclosure statement** This statement tells the borrower **whether the lender intends to service the loan or to transfer it to another lender.** It will also provide information about resolving complaints.

The last page of the GFE is a worksheet that consumers can use to compare different loans and terms to aid in price shopping. The lender is responsible for the accuracy of the GFE and the actual costs that the lender charges on the HUD-1.

### **Uniform Settlement Statement (HUD-1)**

RESPA requires that the Uniform Settlement Statement **itemize all charges that are normally paid by a borrower and a seller in connection with settlement, whether required by the**

**lender or another party, or paid by the lender or any other person.** The third page of the HUD-1 form provides for a comparison of the original GFE estimates to the actual charges appearing on the HUD-1. **Lenders are permitted to "correct" any violation of the tolerances by reimbursing the borrower within 30 days of settlement.**

### **Accounts for taxes and insurance**

While RESPA does not require that escrow accounts be set up, certain government loan programs and some lenders require escrow accounts as a condition of the loan. RESPA **places limits on the amounts that a lender may require:**

- On a monthly basis, the lender may require only one-twelfth of the total of the disbursements for the year, plus an amount necessary to cover a shortage in the account.
- No more than one-sixth of the year's total disbursements may be held as a cushion (a cushion is not required).
- Once a year, the lender must perform an escrow account analysis and return any amount over \$50 to the borrower.

By law, **borrowers have the right to inspect a completed HUD-1 form, to the extent that the figures are available, one business day before the closing.** (Sellers are not entitled to this privilege).

### **Kickbacks and referral fees**

RESPA prohibits the payment of kickbacks, or unearned fees, in any real estate settlement service. It prohibits referral fees when no services are actually rendered. **The payment or receipt of a fee, kickback, or anything of value for referrals for settlement services includes activities such as mortgage loans, title searches, title insurance, attorney services, surveys, credit reports, and appraisals.**

### **TILA-RESPA INTEGRATED DISCLOSURE RULE (TRID)**

In 2010, federal legislation known as the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) created the TILA-RESPA Integrated Disclosure rule as a consumer protection ruling that gives more transparency to the loan process. It does not apply to cash transactions.

The TRID rule applies to most closed-end consumer credit transactions secured by real property. Credit extended to certain trusts for tax or estate planning purpose is not exempt from the TRID rule.

However, some specific categories of loans are excluded from the rule. Specifically, the TRID rule does not apply to HELOCs, reverse mortgages, mortgages secured by a mobile home or by a dwelling that is not attached to real property. The rule also does not apply to loans made by a person or entity that makes five or fewer mortgages in a calendar year.

### **Rule Names**

The formal title of the RULE is "The Integrated Mortgage Disclosures under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z) (2013). Other references to this RULE include:

- CFPB Rule

- TILA-RESPA Rule
- Integrated Disclosures or Integrated Mortgage Disclosures
- CDs or Combined Disclosures or Combined Mortgage Disclosures

### **Transactions Covered By TRID**

- Most loans secured by residential properties
- Vacant Lot loans
- Construction Loans for residential properties
- Purchase and Refinance of residential properties

### **Rule Exceptions**

- Home Equity Lines of Credit (HELOCs)
- Reverse Mortgages
- Mobile Homes or Dwellings not permanently attached to land
- Creditors who provide 5 or fewer loans per year

### **LOAN APPLICATION PROCEDURE**

In normal loan application procedures, the Creditor (Borrower) fills out worksheets provided by the lender, to facilitate an analysis of the Creditor's (Borrower's) ability to qualify for a loan. However, the Consumer Financial Protection Bureau (CFPB) wants Creditors (Borrowers) to know that these worksheets and forms are NOT an official LOAN ESTIMATE (of loan costs). As a result, the CFPB wants lenders to insert a disclaimer on the top of the worksheets, etc., as follows:

**"YOUR ACTUAL RATE, PAYMENT, AND COST COULD BE HIGHER. GET AN OFFICIAL "LOAN ESTIMATE" BEFORE CHOOSING A LOAN"**

### **Information Needed to Apply for a Loan Under the TILA Rules**

The rules require the lender to provide the LOAN ESTIMATE (COSTS) within THREE DAYS after receiving all of the following information:

1. The Consumer's (Borrower's) NAME
2. The Consumer's (Borrower's) INCOME
3. The Consumer's (Borrower's) SOCIAL SECURITY NUMBER (for obtaining a credit report)
4. The Consumer's (Borrower's) PROPERTY ADDRESS
5. The ESTIMATED VALUE OF THE PROPERTY being purchased by the Consumer (Borrower)
6. The LOAN AMOUNT that is being requested by the Consumer (Borrower)

### Difference Between the Loan Estimate and Closing Disclosure

In essence, the LOAN ESTIMATE is the initial estimate of the loan costs. The CLOSING DISCLOSURE is the final estimate of the loan costs.

LOAN ESTIMATE	CLOSING DISCLOSURE
Shows the consumer the amount of money borrowed, the interest rate, the amount of interest paid, the number of payments, the individual amount of those payments, any associated costs for the loan, and estimate of closing costs, and an estimate of the cash needed to close.	Show the loan terms and charges, but also shows the costs associated with closing and the cash needed to close. It is the documents, which accounts for all debits and credits, that is distributed to participants at the closing.

**NOTE: A BUSINESS DAY MEANS ALL CALENDAR DAYS EXCEPT SUNDAY AND CERTAIN FEDERAL HOLIDAYS**

### Communication of the Consummation and Closing Dates

The rules dictate that the CONSUMER (BORROWER) receives the CLOSING DISCLOSURE at least 3 business days before closing. The CREDITOR (LENDER) can provide this disclosure in person and/or receive a receipt of the delivery of the CLOSING DISCLOSURE to the CONSUMER (BORROWER).

Where the CLOSING DISCLOSURE is sent to the CONSUMER (BORROWER), it is presumed to be received by the CONSUMER (BORROWER) three business days after it has been sent. This applies to situations where the CLOSING DISCLOSURE has been sent by either E-Mail or standard mail (USPS). In order to adhere to this three-day rule, lenders may send the CLOSING DISCLOSURE by standard mail (USPS) up to a week before CONSUMMATION.

**Note: Consummation and closing are not the same. Consummation is the date that the lender and borrower are obligated through the signing of the mortgage documents. Closing is the date of the transfer of title. The dates may be the same, but not always.**

Closing may occur any time after the consummation as long as any of the following does not occur: changes to the APR of more than  $\frac{1}{8}\%$  (0.125%), changes to the loan product, or addition of a prepayment penalty. If a change does occur, a new Closing Disclosure is required and a new three-day waiting period begins.

### PREPARATION OF CLOSING STATEMENTS

A typical real estate transaction requires accounting for the expenses incurred by either party, generally on the HUD-1, a form required for any federally related closing. All expenses must be itemized to arrive at the **exact amount of cash required from the buyer and the net proceeds to the seller**. These include prorated items those prepaid by the sellers for which they must be reimbursed and expenses the seller has incurred but for which the buyer will be charged.

# Closing Disclosure

Seller

## Closing Information

**Date Issued** 02/04/2020  
**Closing Date** 02/04/2020  
**Disbursement Date** 02/04/2020  
**Settlement Agent** Title Company  
**File #** Test 02.04.2020  
**Property**

## Transaction Information

**Borrower** Buyer  
**Seller** Seller

**Sale Price** \$200,000

## Summaries of Transactions

### SELLER'S TRANSACTION

**M. Due to Seller at Closing** \$200,000.00

01 Sale Price of Property \$200,000.00  
02 Sale Price of Any Personal Property Included in Sale  
03  
04  
05  
06  
07  
08

### Adjustments for Items Paid by Seller in Advance

09 City/Town Taxes  
10 County Taxes  
11 Assessments  
12  
13  
14  
15  
16

**N. Due from Seller at Closing** \$2,553.00

01 Excess Deposit  
02 Closing Costs Paid at Closing (J) \$2,553.00  
03 Existing Loan(s) Assumed or Taken Subject to  
04 Payoff of First Mortgage Loan  
05 Payoff of Second Mortgage Loan  
06  
07  
08 Seller Credit  
09  
10  
11  
12  
13

### Adjustments for Items Unpaid by Seller

14 City/Town Taxes  
15 County Taxes  
16 Assessments  
17  
18  
19

### CALCULATION

Total Due to Seller at Closing (M) \$200,000.00  
Total Due from Seller at Closing (N) -\$2,553.00

Cash ☐ From ☒ To Seller \$197,447.00

## Contact Information

### REAL ESTATE BROKER (B)

**Name**  
**Address**  
**License ID**  
**Contact**  
**Contact License ID**  
**Email**  
**Phone**

### REAL ESTATE BROKER (S)

**Name**  
**Address**  
**License ID**  
**Contact**  
**Contact License ID**  
**Email**  
**Phone**

### SETTLEMENT AGENT

**Name** Title Company  
**Address**  
**License ID**  
**Contact**  
**Contact License ID**  
**Email**  
**Phone**



## Closing Cost Details

Loan Costs	Seller-Paid	
	At Closing	Before Closing
<b>A. Origination Charges</b>		
01 % of Loan Amount (Points)		
02 Document Fee to LENDER		
03 Processing Fee to LENDER		
04 Underwriting Fee to LENDER		
05 Wire Fee to LENDER		
06		
07		
08		
<b>B. Services Borrower Did Not Shop For</b>		
01 Appraisal to Appraiser		
02 Flood Cert to First American		
03		
04		
05		
06		
07		
08		
09		
10		
<b>C. Services Borrower Did Shop For</b>		
01 Title - Abstract Title Search to Title Company	\$150.00	
02 Title - ALTA 8.1 & 9 Endorsement to Title Company		
03 Title - Chain of Title Fee to Title Company		
04 Title - Commitment Later Date Fee to Title Company	\$125.00	
05 Title - Courier / Wire Fee to Title Company		
06 Title - CPL to UNDERWRITER	\$50.00	
07 Title - IAPLD to Title Company		
08 Title - IL Policy Fee to UNDERWRITER	\$3.00	
09 Title - Lender Email Package Fee to Title Company		
10 Title - Loan Policy to Title Company / UNDERWRITER		
11 Title - Location Note Endorsement to Title Company		
12 Title - Policy Update Fee to Title Company	\$125.00	
13 Title - Settlement / Closing Fee to Title Company		

Other Costs		
<b>E. Taxes and Other Government Fees</b>		
01 Recording Fees	Deed: \$98.00 Mortgage: \$98.00	
02		
<b>F. Prepaids</b>		
01 Homeowner's Insurance Premium ( mo.)		
02 Mortgage Insurance Premium ( mo.)		
03 Prepaid Interest ( per day from to )		
04 Property Taxes ( mo.)		
05		
<b>G. Initial Escrow Payment at Closing</b>		
01 Homeowner's Insurance		
02 Mortgage Insurance		
03 Property Taxes		
04		
05		
06		
07		
08 Aggregate Adjustment		
<b>H. Other</b>		
01 Buyer Attorney Fee to Attorney		
02 Seller Attorney Fee to Attorney		\$400.00
03 Title - Owners Policy to Title Company / UNDERWRITER		\$1,700.00
04		
05		
06		
07		
08		
<b>J. TOTAL CLOSING COSTS</b>		\$2,553.00

## Closing Disclosure - Attachment

**Borrower:**

**Seller:**

**Settlement Agent:** Title Company

**Closing Date:** February 4, 2020

**Disbursement Date:** February 4, 2020

**Property Location:**

Buyer

## Closing Disclosure

This form is a statement of final loan terms and closing costs. Compare this document with your Loan Estimate.

Closing Information		Transaction Information		Loan Information	
<b>Date Issued</b>	02/04/2020	<b>Borrower</b>	Buyer	<b>Loan Term</b>	30 years
<b>Closing Date</b>	02/04/2020			<b>Purpose</b>	Purchase
<b>Disbursement Date</b>	02/04/2020			<b>Product</b>	
<b>Settlement Agent</b>	Title Company	<b>Seller</b>	Seller	<b>Loan Type</b>	<input checked="" type="checkbox"/> Conventional <input type="checkbox"/> FHA
<b>File #</b>	Test 02.04.2020			<input type="checkbox"/> VA <input type="checkbox"/>	
<b>Property</b>		<b>Lender</b>	LENDER	<b>Loan ID #</b>	
<b>Sale Price</b>	\$200,000			<b>MIC #</b>	

Loan Terms		Can this amount increase after closing?
<b>Loan Amount</b>	\$160,000	<b>NO</b>
<b>Interest Rate</b>	4%	<b>NO</b>
<b>Monthly Principal &amp; Interest</b> <i>See Projected Payments below for your Estimated Total Monthly Payment</i>	\$763.86	<b>NO</b>
<b>Does the loan have these features?</b>		
<b>Prepayment Penalty</b>		<b>NO</b>
<b>Balloon Payment</b>		<b>NO</b>

Projected Payments		
Payment Calculation	Years 1-30	
Principal & Interest		\$763.86
Mortgage Insurance	+	-
Estimated Escrow <i>Amount can increase over time</i>	+	575.00
<b>Estimated Total Monthly Payment</b>		<b>\$1,338.86</b>
<b>Estimated Taxes, Insurance &amp; Assessments</b> <i>Amount can increase over time See page 4 for details</i>	\$575.00 a month	<b>This estimate includes</b> <input checked="" type="checkbox"/> Property Taxes <input checked="" type="checkbox"/> Homeowner's Insurance <b>In escrow?</b> <b>YES</b> <b>YES</b> <i>See Escrow Account on page 4 for details. You must pay for other property costs separately.</i>

Costs at Closing		
<b>Closing Costs</b>	\$9,778.20	Includes \$4,628 in Loan Costs + \$5,150.20 in Other Costs. <i>See page 2 for details.</i>
<b>Cash to Close</b>	\$49,778.20	Includes Closing Costs. <i>See Calculating Cash to close on page 3 for details.</i>

## Closing Cost Details

Loan Costs	Borrower-Paid		Paid by Others
	At Closing	Before Closing	
<b>A. Origination Charges</b>	<b>\$1,325.00</b>		
01 % of Loan Amount (Points)			
02 Document Fee to LENDER	\$175.00		
03 Processing Fee to LENDER	\$330.00		
04 Underwriting Fee to LENDER	\$770.00		
05 Wire Fee to LENDER	\$50.00		
06			
07			
08			
<b>B. Services Borrower Did Not Shop For</b>	<b>\$450.00</b>		
01 Appraisal to Appraiser	\$375.00		
02 Flood Cert to First American	\$75.00		
03			
04			
05			
06			
07			
08			
09			
10			
<b>C. Services Borrower Did Shop For</b>	<b>\$2,853.00</b>		
01 Title - Abstract Title Search to Title Company			
02 Title - ALTA 8.1 & 9 Endorsement to Title Company	\$175.00		
03 Title - Chain of Title Fee to Title Company	\$250.00		
04 Title - Commitment Later Date Fee to Title Company			
05 Title - Courier / Wire Fee to Title Company	\$50.00		
06 Title - CPL to UNDERWRITER	\$75.00		
07 Title - IAPLD to Title Company	\$75.00		
08 Title - IL Policy Fee to UNDERWRITER	\$3.00		
09 Title - Lender Email Package Fee to Title Company	\$50.00		
10 Title - Loan Policy to Title Company / UNDERWRITER	\$500.00		
11 Title - Location Note Endorsement to Title Company	\$175.00		
12 Title - Policy Update Fee to Title Company	\$125.00		
13 Title - Settlement / Closing Fee to Title Company	\$1,375.00		
<b>D. TOTAL LOAN COSTS (Borrower-Paid)</b>	<b>\$4,628.00</b>		
Loan Costs Subtotals (A + B + C)	\$4,628.00		

## Closing Cost Details

Other Costs	Borrower-Paid		Paid by Others
	At Closing	Before Closing	
<b>E. Taxes and Other Government Fees</b>	<b>\$196.00</b>		
01 Recording Fees Deed: \$98.00 Mortgage: \$98.00	\$196.00		
02			
<b>F. Prepays</b>	<b>\$1,355.89</b>		
01 Homeowner's Insurance Premium (12 mo.) to HOI	\$900.00		
02 Mortgage Insurance Premium ( mo.)			
03 Prepaid Interest (\$17.53425 per day from 2/4/2020 to 3/1/2020)	\$455.89		
04 Property Taxes ( mo.)			
05			
<b>G. Initial Escrow Payment at Closing</b>	<b>\$3,098.31</b>		
01 Homeowner's Insurance \$75.00 per month for 3 mo.	\$225.00		
02 Mortgage Insurance			
03 Property Taxes \$500.00 per month for 6 mo.	\$3,000.00		
04			
05			
06			
07			
08 Aggregate Adjustment	-\$126.69		
<b>H. Other</b>	<b>\$500.00</b>		
01 Buyer Attorney Fee to Attorney	\$500.00		
02 Seller Attorney Fee to Attorney			
03 Title - Owners Policy to Title Company / UNDERWRITER			
04			
05			
06			
07			
08			
<b>I. TOTAL OTHER COSTS (Borrower-Paid)</b>	<b>\$5,150.20</b>		
Other Costs Subtotals (E + F + G + H)	\$5,150.20		
<b>J. TOTAL CLOSING COSTS (Borrower-Paid)</b>	<b>\$9,778.20</b>		
Closing Costs Subtotals (D + I)	\$9,778.20		
Lender Credits			

### Calculating Cash to Close

Use this table to see what has changed from your Loan Estimate.

	Loan Estimate	Final	Did this change?
Total Closing Costs (J)	\$0	\$9,778.20	YES
Closing Costs Paid Before Closing	\$0	\$0	NO
Closing Costs Financed (Paid from your Loan Amount)	\$0	\$0	NO
Down Payment/Funds from Borrower	\$0	\$40,000.00	YES
Deposit	\$0	\$0	NO
Funds for Borrower	\$0	\$0	NO
Seller Credits	\$0	\$0	NO
Adjustments and Other Credits	\$0	\$0	NO
<b>Cash to Close</b>	\$0	\$49,778.20	

### Summaries of Transactions

Use this table to see a summary of your transaction.

#### BORROWER'S TRANSACTION

<b>K. Due from Borrower at Closing</b>	<b>\$209,778.20</b>
01 Sale Price of Property	\$200,000.00
02 Sale Price of Any Personal Property Included in Sale	
03 Closing Costs Paid at Closing (J)	\$9,778.20
04	
<b>Adjustments</b>	
05	
06	
07	
<b>Adjustments for Items Paid by Seller in Advance</b>	
08 City/Town Taxes	
09 County Taxes	
10 Assessments	
11	
12	
13	
14	
15	
<b>L. Paid Already by or on Behalf of Borrower at Closing</b>	<b>\$160,000.00</b>
01 Deposit	
02 Loan Amount	\$160,000.00
03 Existing Loan(s) Assumed or Taken Subject to	
04	
05 Seller Credit	
<b>Other Credits</b>	
06	
07	
<b>Adjustments</b>	
08	
09	
10	
11	
<b>Adjustments for Items Unpaid by Seller</b>	
12 City/Town Taxes	
13 County Taxes	
14 Assessments	
15	
16	
17	
<b>CALCULATION</b>	
Total Due from Borrower at Closing (K)	\$209,778.20
Total Paid Already by or on Behalf of Borrower at Closing (L)	-\$160,000.00
<b>Cash to Close</b> <input checked="" type="checkbox"/> From <input type="checkbox"/> To Borrower	<b>\$49,778.20</b>

#### SELLER'S TRANSACTION

<b>M. Due to Seller at Closing</b>	
01 Sale Price of Property	
02 Sale Price of Any Personal Property Included in Sale	
03	
04	
05	
06	
07	
08	
<b>Adjustments for Items Paid by Seller in Advance</b>	
09 City/Town Taxes	
10 County Taxes	
11 Assessments	
12	
13	
14	
15	
16	
<b>N. Due from Seller at Closing</b>	
01 Excess Deposit	
02 Closing Costs Paid at Closing (J)	
03 Existing Loan(s) Assumed or Taken Subject to	
04 Payoff of First Mortgage Loan	
05 Payoff of Second Mortgage Loan	
06	
07	
08 Seller Credit	
09	
10	
11	
12	
13	
<b>Adjustments for Items Unpaid by Seller</b>	
14 City/Town Taxes	
15 County Taxes	
16 Assessments	
17	
18	
19	
<b>CALCULATION</b>	
Total Due to Seller at Closing (M)	
Total Due from Seller at Closing (N)	
<b>Cash</b> <input type="checkbox"/> From <input type="checkbox"/> To Seller	

## Additional Information About This Loan

### Loan Disclosures

#### Assumption

If you sell or transfer this property to another person, your lender

- ☐ will allow, under certain conditions, this person to assume this loan on the original terms.  
☒ will not allow assumption of this loan on the original terms.

#### Demand Feature

Your loan

- ☐ has a demand feature, which permits your lender to require early repayment of the loan. You should review your note for details.  
☒ does not have a demand feature.

#### Late Payment

If your payment is more than \_\_\_\_\_ days late, your lender will charge a late fee of \_\_\_\_\_.

#### Negative Amortization (Increase in Loan Amount)

Under your loan terms, you

- ☐ are scheduled to make monthly payments that do not pay all of the interest due that month. As a result, your loan amount will increase (negatively amortize), and, your loan amount will likely become larger than your original loan amount. Increases in your loan amount lower the equity you have in this property.  
☐ may have monthly payments that do not pay all of the interest due that month. If you do, your loan amount will increase (negatively amortize), and, as a result, your loan amount may become larger than your original loan amount. Increases in your loan amount lower the equity you have in this property.  
☒ do not have a negative amortization feature.

#### Partial Payments

Your lender

- ☐ may accept payments that are less than the full amount due (partial payments) and apply them to your loan.  
☐ may hold them in a separate account until you pay the rest of the payment, and then apply the full payment to your loan.  
☐ does not accept any partial payments.

If this loan is sold, your new lender may have a different policy.

#### Security Interest

You are granting a security interest in \_\_\_\_\_.

You may lose this property if you do not make your payments or satisfy other obligations for this loan.

#### Escrow Account

**For now,** your loan

- ☒ will have an escrow account (also called an "impound" or "trust" account) to pay the property costs listed below. Without an escrow account, you would pay them directly, possibly in one or two large payments a year. Your lender may be liable for penalties and interest for failing to make a payment.

Escrow		
Escrowed Property Costs over Year 1	\$6,900.00	Estimated total amount over year 1 for your escrowed property costs: <i>Property Taxes</i> <i>Homeowner's Insurance</i>
Non-Escrowed Property Costs over Year 1	\$0.00	Estimated total amount over year 1 for your non-escrowed property costs:  You may have other property costs.
Initial Escrow Payment	\$3,098.31	A cushion for the escrow account you pay at closing. See Section G on page 2.
Monthly Escrow Payment	\$575.00	The amount included in your total monthly payment.

- ☐ will not have an escrow account because ☐ you declined ☐ your lender does not offer one. You must directly pay your property costs, such as taxes and homeowner's insurance. Contact your lender to ask if your loan can have an escrow account.

No Escrow		
Estimated Property Costs over Year 1		Estimated total amount over year 1. You must pay these costs directly, possibly in one or two large payments a year.
Escrow Waiver Fee		

#### In the future,

Your property costs may change and, as a result, your escrow payment may change. You may be able to cancel your escrow account, but if you do, you must pay your property costs directly. If you fail to pay your property taxes, your state or local government may (1) impose fines and penalties or (2) place a tax lien on this property. If you fail to pay any of your property costs, your lender may (1) add the amounts to your loan balance, (2) add an escrow account to your loan, or (3) require you to pay for property insurance that the lender buys on your behalf, which likely would cost more and provide fewer benefits than what you could buy on your own.



#### Loan Calculations

<b>Total of Payments.</b> Total you will have paid after you make all payments of principal, interest, mortgage insurance, and loan costs, as scheduled.	\$269,657.61
<b>Finance Charge.</b> The dollar amount the loan will cost you.	\$108,438.61
<b>Amount Financed.</b> The loan amount available after paying your upfront finance charge.	\$154,567.56
<b>Annual Percentage Rate (APR).</b> Your costs over the loan term expressed as a rate. This is not your interest rate.	4.39%
<b>Total Interest Percentage (TIP).</b> The total amount of interest that you will pay over the loan term as a percentage of your loan amount.	64.426%

**Questions?** If you have questions about the loan terms or costs on this form, use the contact information below. To get more information or make a complaint, contact the Consumer Financial Protection Bureau at [www.consumerfinance.gov/mortgage-closing](http://www.consumerfinance.gov/mortgage-closing)

#### Other Disclosures

##### Appraisal

If the property was appraised for your loan, your lender is required to give you a copy at no additional cost at least 3 days before closing. If you have not yet received it, please contact your lender at the information listed below.

##### Contract Details

See your note and security instrument for information about

- what happens if you fail to make your payments,
- what is a default on the loan,
- situations in which your lender can require early repayment of the loan, and
- the rules for making payments before they are due.

##### Liability after Foreclosure

If your lender forecloses on this property and the foreclosure does not cover the amount of unpaid balance on this loan,

- ☐ state law may protect you from liability for the unpaid balance. If you refinance or take on any additional debt on this property, you may lose this protection and have to pay any debt remaining even after foreclosure. You may want to consult a lawyer for more information.
- ☒ state law does not protect you from liability for the unpaid balance.

##### Refinance

Refinancing this loan will depend on your future financial situation, the property value, and market conditions. You may not be able to refinance this loan.

##### Tax Deductions

If you borrow more than this property is worth, the interest on the loan amount above this property's fair market value is not deductible from your federal income taxes. You should consult a tax advisor for more information.

#### Contact Information

	Lender	Mortgage Broker	Real Estate Broker (B)	Real Estate Broker (S)	Settlement Agent
<b>Name</b>	LENDER				Title Company
<b>Address</b>					
<b>NMLS ID</b>					
<b>License ID</b>					
<b>Contact</b>					
<b>Contact NMLS ID</b>					
<b>Contact License ID</b>					
<b>Email</b>					
<b>Phone</b>					

#### Confirm Receipt

By signing, you are only confirming that you have received this form. You do not have to accept this loan because you have signed or received this form.

\_\_\_\_\_  
Date

## Closing Disclosure - Attachment

**Borrower:**

**Seller:**

**Lender:** LENDER

**Settlement Agent:** Title Company

**Closing Date:** February 4, 2020

**Disbursement Date:** February 4, 2020

**Property Location:**

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### Confirm Receipt

By signing, you are only confirming that you have received this form. You do not have to accept this loan because you have signed or received this form.

---

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Date

## How the Closing Statement Works

The completion of a closing statement involves an accounting of the parties' debits and credits. A debit is an amount that a party owes and must pay at closing. A credit is an amount entered in a person's favor, an amount that has already been paid, an amount being reimbursed, or an amount the buyer promises to pay in the form of a loan.

**A *debit* is an amount *to be paid* by the buyer or seller**

**A *credit* is an amount *payable* to the buyer or seller.**

A similar procedure is followed to determine how much money the seller actually will receive. The seller's debits and credits are each totaled. The credits include the purchase price plus the buyer's share of any prorated items that the seller has prepaid. The seller's debits include expenses, the seller's share of prorated items to be paid later by the buyer, and the balance of any mortgage loan or other lien that the seller pays off. Finally, the total of the seller's debits is subtracted from the total credits to arrive at the amount the seller will receive.

## Broker's commission

The responsibility for paying the broker's commission will have been **determined by previous agreement**. If the broker is the agent for the seller, the seller normally is responsible for paying the commission. If an agency agreement exists between a broker and the buyer, or if two agents are involved, one for the seller and one for the buyer, the commission may be distributed as an expense between both parties or according to some other arrangement.

## Attorney's fees

If either of the parties' attorneys will be paid from the closing proceeds, that party will be charged with the expense in the closing statement. This expense may include fees for the preparation or review of documents or for representing the parties at settlement.

## Recording expenses

**The seller usually pays for recording charges (filing fees) necessary to clear all defects and furnish the purchaser with a marketable title.** Items customarily charged to the seller include the recording of release deeds or satisfaction of mortgages, quitclaim deeds, affidavits, and satisfaction of mechanics' liens. **The buyer pays for recording charges that arise from the actual transfer of title.** Usually, such items include recording the deed that conveys title to the purchaser and a mortgage or deed of trust executed by the buyer.

## Transfer tax

Most states require some form of transfer tax, conveyance fee, or tax stamps on real estate conveyances. **In Illinois, state and county transfer taxes are usually paid by the seller in accordance with most sales contracts. Local ordinances usually establish which party is responsible for paying municipal transfer taxes.**

### **Title expenses**

Responsibility for title expenses varies according to local custom. In most areas, the seller is required to furnish evidence of good title and pay for the title search. If the buyer's attorney inspects the evidence or if the buyer purchases a title insurance policy, the buyer is charged for the expense.

Because the seller usually is required by the contract to furnish evidence of good title, the seller customarily pays for the owner's title insurance policy. The buyer customarily pays for the lender's policy, which ensures that the lender has a valid first lien.

### **Loan fees**

The discussion of loan fees becomes even more critical with the new good-faith estimate form associated with the new HUD-1 form. For a new loan, the lender generally charges an origination fee and possibly discount points if the borrower wants a below-market interest rate. These lender charges for taking, underwriting, and processing the loan application, including points and origination fees, may not increase prior to closing. If they do, the lender may elect to reissue a new GFE, thereby triggering a three-day waiting period to closing (to allow the buyer time to "shop" for a new loan) or to "correct" the problem with a reimbursement within 30 days of closing. If the buyer assumes the seller's existing financing, the buyer may be required to pay an assumption fee. Also, under the terms of some mortgage loans, the seller may be required to pay a prepayment charge or penalty for paying off the mortgage loan before its due date.

### **Tax reserves and insurance reserves (escrow or impound accounts)**

Most mortgage lenders require that borrowers provide reserve funds or escrow accounts to pay future real estate taxes and mortgage insurance premiums. A borrower starts the account at closing by depositing funds to cover at least the amount of unpaid real estate taxes from the date of lien to the end of the current month. (The buyer receives a credit from the seller at closing for any unpaid taxes). Afterward, an amount equal to one month's portion of the estimated taxes and mortgage insurance, if applicable, is included in the borrower's monthly mortgage payment.

The borrower is responsible for maintaining adequate fire or hazard insurance as a condition of the mortgage loan. Generally, the first year's premium is paid in full at closing. An amount equal to one month's premium is paid after that. The borrower's monthly loan payment includes the principal and interest on the loan, plus one-twelfth of the estimated taxes and insurance (PITI). The taxes and insurance are held by the lender in the escrow or impound account until the bills are due.

### **In Practice**

RESPA permits lenders to maintain a cushion equal to one-sixth of the total estimated amount of annual taxes and insurance. However, if state law or mortgage documents allow for a smaller cushion, the lesser amount prevails.

### **Appraisal fees**

The purchaser usually pays the appraisal fees. When the buyer obtains a mortgage, it is customary for the lender to require an appraisal, and the buyer bears the cost. If the fee is paid at the time of the loan application, it is reflected on the closing statement as already having been paid.

### Survey fees

The purchaser who obtains new mortgage financing customarily pays the survey fees. The sales contract may require the seller to furnish a survey. Lenders usually require a new spot survey. **Most real estate contracts in Illinois require that the seller furnish a current survey to the buyer. As a result, the expense of preparing a survey usually is borne by the seller.**

### Additional fees

An FHA borrower owes a lump sum for payment of the mortgage insurance premium (MIP) if it is not financed as part of the loan. A VA mortgagor pays a funding fee directly to the VA at closing. If a conventional loan carries private mortgage insurance, the buyer prepays one year's insurance premium at closing.

### Accounting for Expenses

Expenses paid out of the closing proceeds are debited only to the party making the payment. Occasionally, an expense item, such as an escrow fee, a settlement fee, or a transfer tax, may be shared by the buyer and the seller. In this case, each party is debited for its share of the expense.

### PRORATIONS

Most closings involve the division of financial responsibility between the buyer and seller for such items as loan interest, taxes, rents, fuel, and utility bills. These allowances are called **prorations**. **Prorations are necessary to ensure that expenses are divided fairly between the seller and the buyer.**

**Accrued items** such as water bills, Illinois real estate taxes, and interest on an assumed mortgage that is paid in arrears are expenses to be prorated that are **owed by the seller but later will be paid by the buyer**. **The seller, therefore, pays for these items by giving the buyer credits for them at closing.**

**Prepaid items**, such as fuel oil in a tank, are expenses to be prorated that have been prepaid by the seller but not fully used up. **They are, therefore, credits to the seller.**

### The Arithmetic of Prorating

Accurate prorating involves four considerations:

- Nature of the item being prorated
- Whether it is an accrued item that requires the determination of an earned amount
- Whether it is a prepaid item that requires the determination of an unearned amount (that is, a refund to the seller)
- What arithmetic processes must be used

***Accrued items = buyer credits***

***Prepaid items = seller credits***

Using this general principle, there are two methods of calculating prorations:

- The yearly charge is divided by a 360-day year (commonly called a *statutory*, or *banking*, year), or 12 months of 30 days each.

- The yearly charge is divided by 365 (366 in a leap year) to determine the daily charge. Then the actual number of days in the proration period is determined, and this number is multiplied by the daily charge.

The *statutory month variation* is also acceptable in Illinois. In this method,

- The yearly charge is divided by 12 to determine a monthly amount.
- The monthly charge is then divided by the actual number of days in the month in which the closing occurs. This final number is the daily charge for that month.

**In Illinois, we use the following to calculate prorations:**

- **Standard year of 360 days**
- **Standard month of 30 days**

### **Accrued Items**

When the real estate tax is levied for the calendar year and is payable during that year or in the following year, **the accrued portion is for the period from January 1 through and including the date of closing.** If the current tax bill has not yet been issued, the parties must agree on an estimated amount based on the previous year's bill and any known changes in assessment or tax levy for the current year.

### **Sample proration calculation**

Assume a sale is to be closed on September 17. Current real estate taxes of \$1,200 are to be prorated. A 360-day year is used. The accrued period, then, is 8 months and 17 days. First, determine the prorated cost of the real estate tax per month and day:

$$\$1,200/12 = \text{Monthly Taxes of } \$100$$

$$8 \times \$100 = \$800$$

$$\$100/30 = \text{Daily Taxes} = \$3.33$$

$$17 \times \$3.33 = \$56.67$$

$$\text{Total Taxes owed for 8 months and 17 days}$$

$$\$800 + \$56.67 = \$856.67$$

This amount represents the seller's accrued earned tax. It will be a **credit to the buyer** and a debit to the seller on the closing statement.

### **Prepaid Items**

A prepaid cost is usually associated with the seller. The seller has paid a cost, but some of the benefits of the cost will be enjoyed by the buyer. The buyer then has to pay the seller at closing for the buyer's portion of the cost attributed to the buyer's use.

One example of a prepaid item is a water bill. Assume that the water is billed in advance by the city without using a meter. The six months' billing is \$60 for the period ending October 31. The sale is to be closed on August 3. Because the water bill is paid to October 31, the prepaid time must be computed. Using a 30-day basis, the time period is the 27 days left in August plus 2 full months.

Monthly water cost  
 $\$60/6 \text{ months} = \$10 \text{ per month}$   
Daily water cost  
 $\$10/30 \text{ days} = \$0.33 \text{ per day}$   
Buyer use of Prepaid Water Cost 2 months and 27 days  
Total Cost Attributed to Buyer Use  $2 \times 10 = \$20.00$   
 $27 \times \$0.33 = \$9.00$   
 $\$20.00 + \$9.00 = \$29.00$

This is a prepaid item; it is credited to the seller and debited to the buyer on the closing statement.

### General Rules for Prorating

The rules or customs governing the computation of prorations for the closing of a real estate sale vary greatly from state to state. The following are some general guidelines for preparing the closing statement:

- In Illinois, the **seller owns the property on the day of closing**, and prorations or apportionments usually are made to and including the day of closing.
- Mortgage interest, general real estate taxes, water taxes, insurance premiums, and similar expenses usually are computed by using **360 days in a year and 30 days in a month**.
- **Accrued general real estate taxes are prorated at the closing.** When the amount of the current real estate tax cannot be determined definitely, the proration is usually based on the last obtainable tax bill.
- Special assessments for municipal improvements such as sewers, water mains, or streets usually are paid in annual installments over several years, with annual interest charged on the outstanding balance of future installments. **The seller normally pays the current installment, and the buyer assumes all future installments.**
- **Rents are usually adjusted on the basis of the actual number of days in the month of closing.** It is customary for the **seller to receive the rents for the day of closing** and to **pay all expenses for that day**. If any rents for the current month are uncollected when the sale is closed, the buyer often agrees by a separate letter to collect the rents if possible and remit the pro-rata share to the seller.
- Security deposits made by tenants to cover the last month's rent of the lease or to cover the cost of repairing damage caused by the tenant generally are transferred by the seller to the buyer.

### Real estate taxes

In Illinois real estate taxes are **paid in arrears**. The **buyer must be credited for any taxes that still will be paid in the future for time in the "past" (i.e., up until closing) when the seller occupied the property**. If an unpaid installment based on last year has been billed, this specific amount is credited to the buyer and debited to the seller. The buyer must be credited with the current year's taxes to the time of dosing because those taxes will not be paid until next year (again by the buyer/new owner). Consequently, the seller is debited accordingly, through the date of close, and a proration (and often a tax estimate based on last year's tax) is necessary for this latter figure.

### Mortgage loan interest

On almost every mortgage loan, the interest is paid in arrears, so the buyer and seller must understand that the mortgage payment due on June 1, for example, includes interest due for the month of May. Thus, the buyer who assumes a mortgage on May 31 and makes the June payment pays for the time the seller occupied the property and should be credited with a month's interest.

### CLOSING STATEMENT

#### Computing the prorations and charges

The following list illustrates the various prorations and other amounts to be included in a settlement statement, prepared by the Closing Agent at the Title Company or the lawyer for the buyer or seller:

- Closing date: June 15
- Commission:  $6\% (0.06) \times \$230,000$  sales price = \$13,800
- Seller's mortgage interest:  $7\% (0.07) \times \$115,400$  principal due after June 1 payment = \$8,078 interest per year;  $\$8,078 / 360$  days = \$22.44 interest per day; 15 days of accrued interest to be paid by the seller  $\times \$22.44 = \$336.60$  interest owed by the seller;  $\$115,400 + \$336.60 = \$115,736.60$  payoff of seller's mortgage
- Real estate taxes (estimated at \$3,450):  $\$3,450 / 12$  months = \$287.50 per month;  $\$287.50 / 30$  days = \$9.58 per day
- The earned period, from January 1 to and including June 15 (5 months, 15 days):  $\$287.50 \times 5$  months = \$1,437.50;  $\$9.58 \times 15$  days = \$143.70;  $\$1,437.50 + \$143.70 = \$1,581.20$  seller owes buyer
- Transfer tax (\$0.50 per \$500 of consideration, or fraction thereof):  $\$230,000 \div \$500 = 460$ ;  $460 \times \$0.50 = \$230$  transfer tax owed by seller
- Buyer's tax reserve payment: \$2,012.50 paid to separate account (7/12 of the anticipated county real estate taxes of \$3,450)
- Buyer's one-year hazard insurance payment: \$3 per \$1,000 of appraised value ( $\$230,000 / 1,000 \times 3 = \$690$  paid in advance to insurance company)
- Buyer's first full payment, including July's interest due (15 days  $\times \$22.44 = \$336.60$ ) on August 1
- The seller's loan payoff is \$115,736.60. The seller must pay an additional seller's fee of \$25 to record the mortgage release, as well as \$100 for a pest inspection and \$200 for a survey, as negotiated between the parties.

#### The Uniform Settlement Statement

The Uniform Settlement Statement (HUD-1) used for most residential closings consists of three pages. Sections J and K on the first page are a **summary of the borrower's and the seller's transactions**. At the bottom of the first page, line 303 indicates the **total amount of cash due from (or to) the borrower**. Line 603 indicates the **cash to (or from) the seller**.

The second page **itemizes the settlement charges to be paid from the borrower's funds or from the seller's funds at settlement**. A number of the costs to the buyer must correlate to the GFE that the buyer received within three business days of the loan application. All items in the borrower's column are added up and transferred to line 103 on the first page. All items in the seller's column are added up and transferred to line 502 on the first page.



## HOME WARRANTIES

A Home Warranty is a service contract that covers the replacement or repair of important household appliances and home components that can break down over time. Home warranties can provide a new owner some peace of mind. There are limitations with these plans, and they usually require a co-pay or service call charge. There are limits as to the coverage, and homebuyers should thoroughly read the home warranty protection plan to understand exactly what is covered.

New home construction warranties generally offer limited coverage on most components for the first and second year. Problems can occur when making a home safe from defects. Some home builders' warranties cover all major defects. There can be a cost to the homeowner. The homeowner can buy additional coverage from independent companies. Again, the homebuyer must fully understand the coverage the new home has.

**NOTES:**

[illegible]

## CHAPTER 11: REAL ESTATE AGENCY

### INTRODUCTION TO REAL ESTATE AGENCY

**Illinois no longer recognizes common law agency. Additionally, Illinois no longer allows the use of sub-agency in real estate transactions,** where the representative of the buyer was a sub-agent of the seller. Illinois now recognizes both a seller agency agreement and a buyer agency agreement whereby one agent has a fiduciary relationship with the seller and another agent has a fiduciary relationship with the buyer.

Agency relationships in Illinois are governed under statutory law. The body of law on which Illinois agency is based in Article 15 of the Real Estate License Act of 2000.

### Law Of Agency

In Illinois, the law of agency defines the rights and duties of the principal and the agent. It applies to a variety of business transactions.

Both contract law and real estate licensing laws — in addition to the law of agency— interpret the relationship between real estate licensees and their clients.

**In Illinois, *the Real Estate License Act of 2000 is given precedence in defining legal real estate agency concepts.* Insofar as real estate is considered, Illinois is a statutory agency state that has replaced common-law duties with statutory duties.**

### Definitions

Legally, *agency* refers to a **strict, defined legal relationship.** In the case of real estate, agency is a relationship that a **broker, managing broker, or residential leasing agent (representing the sponsoring broker)** may have with **buyers, sellers, landlords, or tenants.**

Those who hire are **clients**, and those who are hired are **agents**.

**A real estate licensee becomes an agent, through a contractual agreement, whether expressed or implied.** At this point, the real estate licensee actually becomes a legal, loyal agent obligated to work for the client's best interests at all times, so long as those interests are within the law.

### Definitions - Statutory (Real Estate License Act of 2000)

Key terms of the law of agency under Article 15 of the Real Estate License Act of 2000 are defined as follows:

- **Agent** - The individual who is authorized and consents to represent the interests of another person. In the real estate business, a firm's sponsoring broker is the agent and **shares this responsibility with the licensees who work for them.**
- **Agency**- A relationship in which a consumer has given consent (express or implied) to a real estate licensee to represent the consumer in a real property transaction. Consent may be given to a licensee directly or through an affiliated licensee.

- **Brokerage agreement** - An agreement, made verbally or set out in writing, for an agent or firm to provide brokerage services to a consumer and to receive compensation for providing those services.
- **Compensation** - Payment (monetary or otherwise) made to a person or entity for executing services for a client or customer.
- **Consumer** - A person or entity for whom an agent provides services, which are only to be provided by a licensee, or a person or entity who seeks such services from a licensee.

**Confidential information** - Information given by a client to a licensee during the term of a brokerage agreement that:

- the client requests (in writing or verbally) the licensee keep in confidence,
- relates to the client's negotiating position.
- could do damage to the client's negotiating position if disclosed.

**This information must not be shared *unless*:**

- the client gives authorization for the licensee to share the information,
- the information must be shared by law, or
- the information is revealed by some person or entity other than the licensee.

### **Client vs Customer**

There is a distinction between the level of services a licensee (as agent) provides to a client and the level of services a licensee may provide to a customer.

**Customer**— A person or entity for whom a licensee is providing services but who is not represented by the licensee in an agency relationship.

**Client** — The person or entity that a licensee represents in a real property transaction.

The client is the **principal to whom her agent gives advice and counsel** and a **written agency agreement has been signed by the client and agent**. The agent is entrusted with certain confidential information and has fiduciary responsibilities (sometimes called statutory responsibilities) to the principal.

In contrast, the **customer is entitled to factual information and honest dealings** as a consumer but **never receives advice and counsel or confidential information about the principal**. The real estate licensee may provide clerical acts to the customer but does not create a non-agency relationship, as an agent, works for the client.

Just as the agent owes certain duties to the principal, the principal has responsibilities toward the agent. **The principal's primary duties are to comply with the brokerage agreement and cooperate with the agent**. The principal must not hinder the agent and must deal with the agent in good faith. The principal also must compensate the agent according to the terms of the brokerage agreement.

## Fiduciary/Statutory Responsibilities

The agency agreement usually **authorizes the real estate licensee to act for the principal**. The agent's fiduciary relationship of trust and confidence means that the real **estate licensee owes the principal certain duties**. These duties were not simply moral or ethical; they formed the common law of agency and now are the **basis for statutory laws governing real estate transactions**. Under *the common law of agency, an agent owes the principal the duties of care, obedience, loyalty, disclosure, accounting, and confidentiality*.

The six common-law fiduciary duties may be remembered by the acronym COLD AC:

1. Care,
2. Obedience,
3. Loyalty,
4. Disclosure,
5. Accounting, and
6. Confidentiality.

### Care

Agents must exercise a reasonable degree of care while transacting the business entrusted to them by the principal. Principals expect the agent's skill and expertise in real estate matters to be superior to that of the average person. The agent should know all facts pertinent to the principal's affairs, such as the physical characteristics of the property being transferred and the type of financing being used.

If the agent represents the seller, care and skill include helping the seller arrive at an appropriate listing price, discovering and disclosing facts that affect the seller, and properly presenting the contracts that the seller signs. It also means properly marketing the property and helping the seller evaluate the terms and conditions of offers to purchase.

An agent who represents the buyer is expected to help the buyer locate suitable property and evaluate property values, neighborhoods and property conditions, financing alternatives, and offers and counteroffers with the buyer's interest in mind.

An agent who does not make a reasonable effort to properly represent the interests of the principal could be found by a court to have been negligent. The agent is liable to the principal for any loss resulting from the agent's negligence or carelessness. The standard of care will vary from market to market and depends on the expected behavior for a particular type of transaction in a particular area.

### Obedience

The fiduciary relationship obligates the agent to act in good faith at all times, **obeying the principal's instructions in accordance with the contract**. However, that obedience is not absolute. **The agent may not obey instructions that are unlawful or unethical**. On the other hand, **an agent who exceeds the authority assigned in the contract will be liable for any losses that the principal suffers as a result**.

## Loyalty

**The principal's interests come first, even above the self-interest of the agent.** Agents must **not** consider how the result of negotiations will serve their own interests (for instance, by providing them with a higher commission); each agent must perform all services with the goal of promoting the principal's interests. By law, in all fifty states, agents are not permitted to buy property listed with them for their accounts or buy or sell property in which they have personal interest unless they have made that interest known to the principal or purchaser and received that party's consent.

**Illinois license law prohibits an agent from acting as a dual agent in any transaction to which the agent is a party (Buyer or Seller). The agent must be particularly sensitive to any possible conflicts of interest.**

## Disclosure

It is the agent's duty to **keep the principal informed of all facts or information that could affect a transaction.** Duty of disclosure includes disclosure of relevant information or material facts that the agent knows or should have known.

The agent is **obligated to discover facts that a reasonable person would feel are important in choosing a course of action, regardless of whether those facts are favorable or unfavorable to the principal's position.** The agent may be held liable later for a mistake on these issues.

**The Illinois Residential Real Property Disclosure form shifts the responsibility for full disclosure from the real estate agent to the seller.** It requires that **sellers of one to four-unit residential properties fill** out property disclosure forms **revealing any material defects** they are aware of in the real estate for sale.

**The completed forms shall be given to buyers before an offer is made.** If the disclosure **form is delivered after the offer has been accepted** and if it has any **negative disclosures**, the buyer has **three days to cancel the contract.**

Furthermore, if the **seller learns of a new problem after a contract is signed and up until closing, disclosure must be made in writing to the buyer.** In the latter case, the buyer does not have the power to simply cancel the contract. Compensation may be negotiated or the problem remedied by the seller.

Disclosure forms are usually completed by the seller before he signs the listing agreement or at the time of signing. Regardless of the seller's completion of the disclosure form, the seller's agent is required to disclose all material defects known to her, including in cases where the agent knows that the seller has misrepresented the extent or existence of property defects or has not fully disclosed them. An agent for a buyer must disclose deficiencies of a property as well.

## Accounting

Most states' license laws require that **agents periodically report the status of all funds or property received from or on behalf of the principal.** Similarly, most state license laws require that licensees

give **accurate copies of all documents** to all affected parties and keep copies on file for a period of time.

Illinois licensees are **required to deliver true copies of all executed sales contracts to the people who signed them within 24 hours**. In Illinois, **all funds entrusted to a licensee must be deposited in a special escrow account by the next business day** following the signing of a sales contract or lease.

**Commingling** such monies with the licensee's personal or general business funds is illegal.

**Conversion**, the practice of using those escrow funds as the licensee's own money, is illegal as well.

**Licensees should be aware that records of escrow account transactions and reconciliations must be kept on file for at least five years. All records can be kept electronically but must be backed up on a regular basis.**

### **Confidentiality**

**Confidentiality is a key element of fiduciary duties.** Client information obtained during the term of the brokerage agreement **must be kept confidential**. For example, when the principal is the seller, the agent may not reveal such things as the principal's willingness to accept less than the listing price or urgency to sell, ***unless the principal has authorized the disclosure***. If the principal is the buyer, the agent may not disclose that the buyer will pay a higher price, is under a tight moving schedule, or other facts that might **harm the principal's bargaining position**.

These statutory duties, based on (but replacing) common-law duties, are set forth in **Article 15 of the Real Estate License Act of 2000**. An agent may not disclose personal, confidential information about her principal. However, **known material facts about the property's physical condition or its environs must always be disclosed**. A **material fact** is any fact that, if known, might reasonably be expected to affect the course of events.

**Under Section 15-15 (2) (C) of the Act, material facts do not include the following when located on or related to real estate that is not the subject of the transaction:**

- Physical conditions that do not have a substantial adverse effect on the value of the real estate
- Fact situations
- Occurrences

### **Opinion versus Fact**

Real estate licensees and other staff members must always be careful about the statements they make. They must be sure that the **customer understands whether the statement is an opinion or a fact**. **Statements of opinion are permissible only as long as they are offered as opinions and without any intention to deceive.**

**Statements of fact must be accurate. Exaggeration of a property's benefits is called puffing. While puffing is legal**, licensees must ensure that none of their statements can be interpreted as fraudulent.

**Fraud is the intentional misrepresentation of a material fact in such a way as to harm or take advantage of another person.** That includes not only making false statements about a property but also intentionally concealing or failing to disclose important facts.

**The misrepresentation or omission does not have to be intentional to result in licensee liability.** A **negligent misrepresentation** occurs when the licensee **should have known** that a statement about a material fact was false. If the buyer relies on the licensee's statement, the licensee is liable for any damages that result. Similarly, a licensee who accidentally fails to perform some act for instance, forgetting to deliver a counteroffer, may be liable for damages that result from such a negligent omission.

**If a contract to purchase real estate is obtained as a result of fraudulent misstatements, the contract may be disaffirmed or renounced by the purchaser.** In such a case, the licensee not only loses a commission but can be liable for damages if either party suffers loss because of the misrepresentation. If the licensee's misstatements were based on the owner's own inaccurate statements and the licensee had no independent duty to investigate their accuracy, the licensee may be entitled to a commission, even if the buyer rescinds the sales contract.

### **Latent Defects**

**The seller has a duty to disclose any known latent defects that threaten structural soundness or personal safety.** A structural defect that would not normally be uncovered over the course of an ordinary inspection (due to the placement or type of defect, for instance) is referred to as a latent defect. Buyers have been able to either rescind the sales contract or receive damages when a seller fails to reveal known latent defects. The courts also had decided in favor of the buyer when the seller neglected to reveal violations of zoning or building codes.

In addition to the seller's **duty to disclose latent defects**, the seller's licensed real estate agent has an **independent duty to conduct a reasonably competent and diligent inspection of the property**. It is the licensee's duty to discover any material facts that may affect the property's value or desirability, whether or not they are known to or disclosed by the seller. Any such **material facts discovered by the licensee must be disclosed to prospective buyers**. If the licensee should have known about a substantial defect that is detected later by the buyer, **the licensee may be liable to the buyer for any damages resulting from that defect**. The statute of limitations is one year for buyer action.

### **Stigmatized Properties**

Stigmatized properties are those properties that society has branded **undesirable because of events that occurred there**. Stigma is the continuing negative association with or feeling about the property.

**Article 15 of the Real Estate License Act of 2000** states that in dealing with specific situations related to disclosure, "no cause of action shall arise against a licensee for the failure to disclose:

- that an occupant of that property was afflicted with HIV or any other medical condition or
- that the property was the site of an act or occurrence which had no effect on the physical condition of the property or its environment or the structures located thereon."
- no cause of action shall arise against a licensee for the failure to disclose a fact situation on property that is not the subject of the transaction."



- no cause of action shall arise against a licensee for the failure to disclose physical conditions, located on property that are not the subject of the transaction, that do not have a substantial adverse effect on the value of the real estate that is the subject of the transaction."

For any action brought under Article 15, "the court may in its discretion, award only actual damages and court costs or grant injunctive relief, when appropriate." Any action brought under Article 15 **must commence within two years after the person bringing the action knew or should have known of such act or omission**. In no event can the action be brought more than five years after the date on which the act or omission occurred. If the person entitled to bring the action is under the age of 18 or under legal disability, the period of limitation shall not begin to run until the disability is removed.

The **buyer's agent** is the one to suggest the **highest range of prices** the buyer should consider, based on **comparable values and current market**. The agent's aim is to help the buyer get the **lowest price possible**, given all other buyer concerns and needs. The buyer's agent discloses information about how long a property has been listed or why the owner is selling, if known. Of course, a seller's agent who discloses such information violates the agent's fiduciary/statutory duties of loyalty to the seller.

**The seller's disclosure form is a good guide to follow for what must be disclosed to all parties by the listing side of a transaction.** In all other respects, unless it is illegal or a material fact about the property itself, the seller's agent should follow the seller's lawful instructions. A buyer's agent should be on watch and do what research is possible.

### **Megan's Law**

At the state level, Megan's Law is a general name for laws **requiring law enforcement authorities to make information available to the public regarding registered sex offenders**. Individual states decide what information will be made available and how it is to be disseminated. Commonly included information includes the offender's name, picture, address, incarceration date, and nature of the crime. The information is often displayed on public sites but can also be published in newspapers and pamphlets or disseminated through various other means.

At the federal level, Megan's Law is known as the Sexual Offender Act of 1994 and requires persons convicted of sex crimes against children to notify local law enforcement of any change of address or employment after release from custody (such as prison or a psychiatric facility). The notification requirement may be imposed for a fixed period of time, usually at least ten years, or permanently. Some states may legislate registration for all sex crimes, even if no minors were involved. It is a felony in most jurisdictions to fail to register or fail to update information.

As noted, **Article 15, Section 15-20, of the Act** states, "No cause of action shall arise against a licensee for the failure to disclose...fact situations on property that is not the subject of the transaction..."

Listing agents have no legal duty to disclose that a known sex offender resides in a property near a listed home, but skilled buyer's agents should be watchful for any signals of hard-to-identify issues.

Sex offender location lists are public information, and a buyer's agent should refer a buyer client to such lists if asked.

## CREATION OF AGENCY

An agency relationship may be based on a formal agreement between the parties, an express agency, or it may result from the parties' behavior, an implied agency.

### Express agency

The principal and agent may enter into a contract, or an express agreement, in which the parties formally express their intention to establish an agency and state its terms and conditions. The agreement may be either oral or written.

**An agency relationship between a seller and a sponsoring broker generally is created by a written employment contract, commonly referred to as a listing agreement, that authorizes the sponsoring broker (or their designated licensees) to find a buyer or tenant for the owner's property.**

**An express agency relationship between a buyer and a sponsoring broker is created by a buyer agency agreement. Similar to a listing agreement, it stipulates the activities and responsibilities the buyer expects from the sponsoring broker (or their designated licensees) in finding the appropriate property for purchase or rent.**

**The Real Estate License Act of 2000 requires that all exclusive brokerage agreements must be in writing.**

### Implied agency

An agency also may be created by **implied agreement**. This occurs when the **actions of the parties indicate that they have mutually consented to an agency**. A licensee acts on behalf of another as agent. Even though the licensee may not have consciously planned to create an agency relationship, the parties can create one ***unintentionally, inadvertently, or accidentally by their actions.***

### Compensation

**The source** of compensation does not determine agency. A real estate agent does not necessarily represent the person who pays her commission. In fact, agency can exist even if **no fee** is involved; it is called a **gratuitous agency**. The written brokerage agreement should state how the agent is being compensated and explain all the alternatives available.

**NOTE —** With new Buyer Broker Agreements, some or all of the commission paid to the Seller's Agent may be shared with the Buyer Broker legally. The commission does not have to come directly from the Buyer in a Buyer Broker Agreement arrangement.

In Illinois, compensation does not determine the agency relationship. Both buyer's and seller's real estate agents are often paid by the seller in a cooperative commission arrangement. The seller first pays the listing sponsoring broker, and the listing sponsoring broker cuts a check to the cooperating sponsoring broker. Sometimes the seller pays only the listing sponsoring broker and the buyer pays the

buyer's sponsoring broker. Regardless of the particular arrangement, the licensee is required to inform clients in each transaction of how the sponsoring broker will be compensated and how the commission will be split with sponsoring brokers representing other parties.

## TERMINATION OF AGENCY

An agency may be terminated for any of the following reasons:

- Death or *incapacity* of either party
- Destruction or condemnation of the property
- Expiration of the terms of the agency
- Mutual agreement by all parties to the contract
- Breach by one of the parties, in which case the breaching party might be liable for damages,
- By operation of law, as in bankruptcy of the principal (bankruptcy terminates the agency contract, and title to the property transfers to a court-appointed receiver)
- Completion, performance, or fulfillment of the purpose for which the agency was created

In Illinois, a **definite termination date must be included in a brokerage agreement.** Automatic extension clauses are illegal under Illinois law. An agency coupled with an interest is an agency relationship in which the agent has an interest in the subject of the agency, such as the property being sold. An agency coupled with an interest cannot be revoked by the principal or be terminated on the principal's death.

## TYPES OF AGENCY RELATIONSHIPS

### Limitations on an Agent's Authority

A **universal agent** is a person **empowered to do anything the principal could do personally.** The universal agent's authority to act on behalf of the principal is ***virtually unlimited.*** In Illinois, a **written power of attorney** is required to create a universal agency.

A **general agent** may represent the principal in a broad range of matters related to a particular business or activity. The general agent may, for example, **bind the principal to any contract within the scope of the agent's authority.** A property manager is typically considered a general agent to the property owner. Brokers and managing brokers are *general agents to their sponsoring broker.*

A **special agent** is **authorized to represent the principal in one specific act or business transaction only, under detailed instructions.** A *real estate licensee usually is a "special" agent to a client.*

If hired by a **seller,** the licensee is limited to **finding a ready, willing, and able buyer** for the property.

A special agent for a **buyer** (buyer's agent) has the limited responsibility of **finding a property that fits the buyer's criteria.**

As a **special agent,** the **licensee may not bind the principal to a contract.** The principal makes all contractually related decisions and will sign on her own. A special power of attorney is another legal means of authorizing an agent to carry out only a specified act or acts.

Finally, a designated agent is a person authorized by the sponsoring broker to act as the agent of a specific principal - Buyer or Seller. A designated agent is the only licensee in the company who has a **fiduciary responsibility toward that principal**. When one licensee in the company is a designated agent, the others are free to act as agents for the other party in a transaction. In this way, two licensees from the same real estate company may represent opposite sides in a property sale without entering dual agency.

**NOTE** Confidentiality has to be carefully maintained when two agents in the same firm represent the Buyer and Seller. Nothing can be revealed about the Buyer/Seller negotiating position in Sales Meetings or other informal conversations in and out of the office.

**Designated agency is recognized in Illinois.** A sponsoring broker entering into a brokerage agreement may specifically designate those licensees employed by or affiliated with the sponsoring broker to act as legal agents of that client to the exclusion of all other licensees employed by or affiliated with the sponsoring broker. The sponsoring broker will not be considered to be acting for more than one party in a transaction if the licensees specifically designated as legal agents of a person are not representing more than one party in a transaction.

The sponsoring broker must **take care to protect confidential information disclosed by a client to her designated agent**. A designated agent may disclose to her sponsoring broker or persons specified by the sponsoring broker confidential information of a client for the purpose of seeking advice or assistance for the benefit of the client in regard to a possible transaction. The sponsoring broker **cannot disclose confidential information unless otherwise required by this act or requested or permitted by the client who originally disclosed the confidential information**.

### Single Agency

**When an agent or firm represents *only one party (buyer, seller, landlord, or tenant) exclusively in a real estate transaction, this relationship is referred to as single agency***. The agent and firm's fiduciary and statutory duties are provided only to that one party (the principal); the other party in the transaction is referred to as the customer.

While a single agency licensee may represent both sellers and buyers, that licensee **cannot represent both *in the same transaction***. This avoids conflict and results in client-based service and loyalty to only one client. On the other hand, it traditionally rules out the sale of in-house listings to represented buyers.

### Buyer Agency

Many licensees involved with residential property are discovering opportunities for buyer representation. Some licensees have become specialists in the emerging field of **buyer agency**, even representing buyers exclusively. **A buyer agency relationship is established in the same way as any other agency relationship by contract, agreement, or implication.**

**The buyer's agent may receive a fee from the buyer or share in the seller-paid commission to the listing sponsoring broker or both, depending on the terms of the agency agreement. In**

**Illinois, it is common for the listing sponsoring broker to split the listing commission with the buyer's sponsoring broker.**

### **Property Management Agency**

An owner may employ a sponsoring broker to market, lease, maintain, or manage the owner's property. Such an arrangement is known as property *management*. The sponsoring broker is made the agent of the property owner through a property management agreement. As in any other agency relationship, the sponsoring broker has a fiduciary responsibility to the client-owner.

### **Dual Agency**

In **dual agency, the agent represents two principals (Buyer and Seller or Landlord and Tenant) in the same transaction**. Dual agency requires equal loyalty to two separate principals at the same time. The challenge is to fulfill the fiduciary obligations to one principal without compromising the interests of the other, especially when the parties' interests may not only be separate but even opposite. While practical methods of ensuring fairness and equal representation exist, it should be noted that **a dual agent can never fully represent either party's interests. He or She is a Facilitator, not an Agent.**

### **Required Disclosed Dual Agency Disclosure Notice**

**Real estate licensing laws permit dual agency only if the buyer and seller are informed and consent to the licensee's representation of both in the same transaction.** Although the possibility of conflict of interest still exists, disclosure is intended to minimize the risk for the licensee by ensuring that both principals are **aware of the effect of dual agency on their respective interests**.

The disclosure alerts the **principals that they may have to assume greater responsibility for protecting their interests than they would if each had independent representation**. Because the **duties of disclosure and confidentiality are limited by mutual agreement**, they must be **carefully explained** to the parties in order to establish informed consent. Considerable debate focuses on whether licensees can properly represent both the buyer and seller in the same transaction, even though the dual agency is disclosed.

### **Confirmation of Consent to Dual Agency**

Because of the obvious risks inherent in dual agency **ranging from conflicts of interest to outright abuse of trust** Illinois requires that the **buyer and seller sign a dual agency disclosure twice** — once at the **beginning of the transaction** and once **before the sale contract is signed**. **All parties must consent to the arrangement, in writing in Illinois.**

Designated agency is a process that avoids dual agency that may occur during an *in-house* sale in which two different agents are involved. Under designated agency, the sponsoring broker designates one agent to represent the seller and one agent to represent the buyer. Designated agency is legal in Illinois. However, designated agency does not apply to a single agent who represents both parties at the same time in the same transaction.

### Undisclosed dual agency

A licensee may not intend to create a dual agency. It may occur **unintentionally or inadvertently**. Sometimes the cause is carelessness. Other times the licensee does not fully understand her fiduciary responsibilities. Some licensees lose sight of legal obligations when they focus intensely on bringing buyers and sellers together. For example, a licensee representing the seller might tell a buyer that the seller will accept less than the listing price to entice the buyer into making an offer. Or the listing licensee might try to persuade the seller to accept an offer that is really in the buyer's interest. Giving a buyer any specific advice on how much to offer can lead the buyer to believe that the licensee represents the buyer's interests and is acting as the buyer's advocate.

Any of these actions creates an **implied agency with the buyer** and **violate the duties of loyalty and confidentiality to the principal-seller**. Because **neither party has been informed** of that situation and been given the **opportunity to seek separate representation**, the interests of both are jeopardized.

**This undisclosed dual agency is a violation of licensing laws. It can result in rescission of the sales contract, forfeiture of commission, or filing of a suit for damages.**

### Case Studies/Scenarios/Role-playing #1

#### *Designated Agency/Dual Agency*

Broker Derek works for a large real estate firm. His Sponsoring Broker assigned Derek as the designated agent on a new listing, a commercial strip mall consisting of several small retail businesses with long term leases. Because of Derek's many contacts with commercial investors, Derek was able to have one of his qualified investors write an offer. Derek had both the seller and investor sign a dual agency consent form. As Derek was finalizing the transaction, another broker from a different firm contacted Derek and mentioned that he has a client who is interested in purchasing the strip mall.

At this point, what should Derek do?

- A. Broker Derek should wait for the other offer to come in and present both offers at the same time.
- B. Broker Derek should present his current offer now because the other offer might not come through.
- C. Broker Derek should let the seller know there is a possibility of another offer, and the seller should wait a few days.
- D. Broker Derek should let the seller know that he has a written offer ready to present now, and there is a possibility of another offer and ask the seller how they want to proceed.

### Disclosure of Agency

**Real estate licensees are required to disclose the parties they represent**. Understanding the scope of the service a party can expect from the agent allows consumers to make an informed decision about whether to seek their own representation.

**Licensees are considered to be representing the consumer they are working with as the consumer's designated agent (implied agent) unless there is a written agreement between them specifying a different relationship.**

**Article 15, Section 15-35**, discusses agency relationship disclosure. It requires that a consumer be advised in writing that a designated agency relationship exists unless there is a written agreement between the sponsoring broker and the consumer providing for a different brokerage relationship. This must occur no later than beginning to work as a designated (implied) agent on behalf of the consumer.

The name or names of her designated agent or agents must be in writing, and the sponsoring broker's compensation and policy with regard to cooperating with sponsoring brokers who represent other parties in a transaction must be disclosed.

A licensee must also disclose in writing to a customer that the licensee is not acting as the agent of the customer at a time intended to prevent disclosure of confidential information from a customer to a licensee, but in no event later than the preparation of an offer to purchase or lease real property.

### **Customer-Level Services**

An agent's **primary responsibility** is to the principal, and Illinois courts have long held that the contractual principal-agent relationship as defined in a listing agreement or buyer agency agreement gives the seller or buyer a cause of action against the licensee who breaches her fiduciary duties to the client. **The courts have not demanded fiduciary duty to third parties.** However, Illinois license law does set forth the duties that licensees owe to third-party customers (buyers or sellers). Licensees are to treat all customers honestly. They cannot negligently or knowingly give customers false information.

Finally, licensees must disclose all material adverse facts about the physical condition of the property to the customer that are actually known by the licensee and that could not be discovered by a reasonably diligent inspection of the property by the customer (Latent Defects).

In Illinois, a licensee may be held liable to a seller or buyer if the licensee misrepresents material facts about a property and if the seller or buyer suffers monetary loss through reliance on these statements. The licensee's loyalty to the principal is no defense even though the principal may have ordered the agent to misrepresent. **Licensees have a duty to prospective sellers and buyers to disclose all material information within their knowledge.** If the licensee knowingly makes untrue statements, Illinois courts will have no difficulty in finding the licensee liable to the appropriate party.

Furthermore, liability may be imposed when **the licensee is aware of facts that tend to indicate she is making a false statement**. For instance, if the seller tells his agent/licensee that "the roof was replaced last year," and the agent has good reason to believe that statement is untrue, the licensee should attempt to ascertain the truth and pass the correct information on to the buyer. However, if the client provided the false information and the licensee did not have knowledge that the information was false, the licensee will not be held liable to the customer.

Licensees **who attempt to avoid liability** to buyers through the use of a waiver or an exculpatory clause in the sales contract will **probably be unsuccessful**.

**NOTES:**

[illegible]



## CHAPTER 12: CONTRACT LAW

### CONTRACT DEFINITION

**A contract** is a voluntary agreement or promise between legally competent parties, supported by legal consideration, to perform (or refrain from performing) some legal act. That definition may be easier to understand if its various parts are examined separately. A contract must be

- voluntary - no one may be forced into a contract,
- an agreement or a promise - a contract is essentially a legally enforceable promise.
- made by legally competent parties - the parties must be viewed by the law as capable of making a legally binding promise,
- supported by legal consideration - a contract must be supported by something of value that induces a party to enter into the contract, and that something must be legally sufficient to support a contract, and
- having to do with a legal act - no one may legally contract to do something illegal.

Licensees use many types of contracts and agreements to carry out their responsibilities to sellers, buyers, and the general public. The general body of law that governs such agreements is known as *contract law*.

### Express and Implied Contracts

Depending on how a contract is created, it is either express or implied.

- An **express contract** exists when the **parties state the terms and show their intentions in words**. An express contract may be **oral or written**.
- In an **implied contract**, the agreement of the parties is demonstrated by their *acts and conduct*.

### Enforceable Contracts

A contract may be enforceable in two ways:

1. **Enforceable between the parties** - This is our everyday contract which we make with family, friends, co-workers. It depends on the good will of the parties for the contract to be carried out. If one party does not abide by the contract, the **injured party cannot enforce the contract in court if the agreement was an oral contract.**
2. **Enforceable in Court** - only **written contracts** can be **enforceable in court**, with very few exceptions. In Illinois, most of our real estate contracts/agreements have to be in writing.

The Illinois Statute of Frauds requires that any contracts for the sale of land, or for leases that for more than one year from the date they are entered into, must be in writing to be enforceable in court.

### Request Writing/Purchase Agreement/ Offer

Broker Donette has a listing in a very demanding area and priced to sell. In the first few days that the property has been on the market, she has had several showings and now has several offers. Donette has set a deadline for all offers to be sent to her by 5:00 PM today. An agent from another office has a client and has a verbal cash offer for \$25,000 above the listed price. The offer will not be ready until 6:00 PM tonight.

What should Donette do?

- A. Donette should present the written offers that came in by 5:00 PM to the seller
- B. Donette should wait just one more hour for the cash offer.
- C. Donette should let the seller know about the cash offer and proceed to present the written offers now.

The **Illinois Real Estate License Act of 2000** also indicates that certain other contracts must be in writing, such as employment agreements between sponsoring brokers and their sponsored licensees.

## Bilateral and Unilateral Contracts

Contracts may be classified as either ***bilateral or unilateral***.

- In a **bilateral contract**, **both parties promise to do something; one promise is given in exchange for another**. A real estate sales contract is a bilateral contract because the seller promises to sell a parcel of real estate and convey property title to the buyer, who in turn promises to pay a certain sum of money for the property.
- A **unilateral contract**, on the other hand, is a **one-sided agreement**. One party makes a promise to induce a second party to do something. The second party is not legally obligated to act. However, **if the second party does comply, the first party is then obligated to keep the promise**. An option contract to retain one's option to possibly make a purchase later is an example of a unilateral contract.

**Illinois case law supports the proposition that exclusive brokerage contracts are unilateral, not bilateral, contracts. If exclusive brokerage contracts were bilateral contracts, then the listing broker would be in breach of contract if he failed to produce a buyer.**

## Executed and Executory Contracts

A contract may be classified as either ***executed or executory***, depending on whether the agreement is performed.

- An **executed contract** is one in which all parties have **fulfilled their promises**: the contract has been performed. This sometimes can be confused with the word *execute*, which refers to the act of signing a contract.
- An **executory contract** exists when one or both parties **still have an act to perform**. A sales contract is an executory contract from the time it is signed until closing: ownership has not yet changed hands, and the seller has not received the sales price. At closing, the sales contract is executed.

## Essential Elements of a Valid Contract

A contract must meet certain minimum requirements to be considered legally valid. The following are the basic essential elements of a contract:

### Offer and acceptance (mutual assent)

There must be an offer by one party that is accepted by the other party. The **person who makes the offer is the offeror**. The **person who accepts the offer is the offeree**. This requirement also is called **mutual assent**. It means that there must be a **meeting of the minds**, or complete agreement about

the purpose and terms of the contract. **In Illinois, the offer and acceptance must be in writing.** The wording of the contract must express all the agreed-on terms and must be clearly understood by the parties.

An **offer is a promise made by one party, requesting something in exchange for that promise.** The offer is made with the intention that the offeror will be bound to the terms if the offer is accepted. The terms of the offer must be definite and specific and must be communicated to the offeree.

**Proposing any deviation from the terms of the offer constitutes a rejection of the original offer and creates a new offer.** The **original offer ceases to exist** because the seller has rejected it. The buyer may accept or reject the seller's counteroffer. If the buyer desires, the process may continue by making another **counteroffer**. Any change in the last offer may result in a counteroffer until either party reached an agreement or one party walks away.

**Any offer or counteroffer may be withdrawn at any time before it has been accepted, even if the person making the offer or counteroffer agreed to keep the offer open for a set period.**

### Acceptance

If the seller:

- agrees to the original offer or a later counteroffer exactly as it is made
- signs the document,
- the offer has been accepted and a contract is formed.

The **licensee must advise the buyer of the seller's acceptance** and obtain the approval of the parties' attorneys if the contract calls for it. A copy of the contract must be provided to each party. **An offer is not considered accepted until the person making the offer has been notified of the other party's acceptance.**

**The licensee must transmit all offers, acceptances, or other responses as soon as possible** to avoid questions of proper communication.

**Besides being terminated by a counteroffer, an offer may be terminated by the offeree's outright rejection of it.** Alternatively, an **offeree may fail to accept the offer before it expires** if a time frame was attached to the offer.

The **offeror** may *revoke* the offer at any time before receiving the acceptance. This revocation must be communicated to the offeree by the offeror, either directly or through the licensees who are the parties' agents. The offer also is **considered revoked if the offeree learns of the revocation and observes the offeror acting in a manner that indicates that the offer no longer exists.**

### Consideration

The contract **must be based on consideration.** Consideration is something of **legal value** offered by one party and accepted by another **as an inducement to perform or to refrain from performing some act.** There must be a definite statement of consideration in a contract to show that something of value was given (or promised) in exchange for the other party's promise.

Consideration must be **good and valuable between the parties**.

**Good Consideration** — Love and affection

**Valuable Consideration**— Money, things of tangible value (gold, pearls, diamonds)

The courts do not inquire into the adequacy of consideration. Adequate consideration ranges from as little as a promise of "love and affection" to a substantial sum of money. Anything that has been bargained for and exchanged is legally sufficient to satisfy the requirement for consideration. The only requirements are that the parties agree to the consideration and that no undue influence or fraud occurred.

### **Reality of consent**

Under the doctrine of *reality of consent*, a contract must be entered into as the **free and voluntary act of each party**. Each party must be able to make a prudent and knowledgeable decision without undue influence. A mistake, misrepresentation, fraud, undue influence, or duress deprives a person of that ability. If any of these circumstances is present, the contract is voidable by the injured party. If the other party were to sue for breach, as a defense, the injured party could say the agreement lacks reality of consent.

### **Legal purpose**

A contract must be for a **legal purpose** that is, even with all the other elements (consent, competent parties, consideration, and offer and acceptance). A contract for an **illegal purpose** or an act against public policies is **not a valid contract**.

### **Legally competent parties**

All parties to the contract must have legal capacity. That is, they must be of legal age and have enough mental capacity to understand the nature or consequences of their actions in the contract. In most states, 18 is the age of contractual capacity.

### **Validity of Contracts**

A contract can be described as *valid, void, voidable, or unenforceable, depending on the circumstances*.

- A contract is **valid** when it **meets all the essential elements** that make it legally sufficient or enforceable.
- A contract is **void** when it has **no legal force or effect** because it lacks some or all of the essential elements of a contract.
- A contract that is **voidable** appears on the surface to be **valid** but **may be rescinded or disaffirmed** by one or both parties based on some legal principle. If it is not disaffirmed, a voidable contract may nevertheless end up considered by the courts to be valid if the party who has the option to disaffirm the agreement does not do so within a period of time prescribed by state law. Several situations may result in a contract that is voidable:
  - A contract entered into under duress
  - A contract entered into while intoxicated

- As a result of fraud, mistake, or misrepresentation, it is always **voidable by the compelled or defrauded party**.
- A contract with a minor is also voidable; **minors are permitted to disaffirm real estate contracts at any time while underage** and for a certain period of time after reaching majority age.
- Finally, a contract entered into by a mentally ill person usually is voidable *during* the mental illness and for a reasonable period after recovery. On the other hand, a contract made by a person who has been adjudicated insane (that is, found to be insane by a court) is void at the outset based on insanity judgments being a matter of public record.
- A contract that is UNENFORCEABLE is a contract that cannot be completed by operation of law or for some other reason.

Illinois law provides that all persons come of "**legal age**" on their **18th birthday**. **Contracts entered into by a minor in Illinois are voidable until the minor reaches majority and for a reasonable time afterward**. There is no statutory period within which a person may void a contract after reaching majority in Illinois. What is considered "reasonable" depends on the circumstances of each case, although the courts tend to allow a maximum of six months.

## DISCHARGE OF CONTRACTS

### Performance of a Contract

Many contracts call for a specific time by which the agreed-on acts must be completely performed. In addition, many contracts provide that **time is of the essence**. This means that the **contract must be performed within the time limit specified**. A party who fails to perform on time is liable for breach of contract.

In Illinois, a deed or contract executed on a **Sunday or legal holiday is valid and enforceable**. However, when the **last day on which a deed or contract must be executed is a holiday or a Sunday**, the deed or contract **may be executed on the next regular business day**.

## Assignment

### Assignment — New Person

This is a **transfer of rights or duties under a contract**. Rights may be **assigned to a third party** (called the *assignee*) unless the contract forbids it. Obligations also may be assigned (or *delegated*), but the original party remains primarily liable unless specifically released. An assignment may be made without the consent of the other party unless the contract includes a clause that permits or forbids assignment.

### Novation — New Contract

Substitution of a new contract for an existing contract is called novation. The new agreement may be between the same parties, or a new party may be substituted for (this is novation *of the parties*). The parties' intent must be to discharge the old obligation. For instance, when a real estate purchaser assumes the seller's existing mortgage loan, the lender may choose to release the seller and substitute the buyer as the party primarily liable for the mortgage debt. When there are many changes to a real

estate contract and it is faxed several times, the contract may not be legible. Novation occurs when a new, clear contract with all the accepted changes is signed by all the parties.

**Assignment = *substitution of parties***

**Novation = *substitution of contracts***

### **Breach of Contract**

A contract **may be terminated if it is breached by one of the parties**. A **breach of contract is a violation of any of the terms or conditions of a contract without legal excuse**. The breaching or defaulting party assumes certain burdens, and the non-defaulting party has certain remedies.

### **Seller Breach**

If the **seller breaches a real estate sales contract**, the:

- **The buyer may sue for specific performance** unless the contract specifically states otherwise. In a suit for specific performance, **the buyer asks the court to force the seller to go through with the sale and convey the property as previously agreed**.
- The buyer may also choose to sue for damages alone,
- The buyer may choose to sue for specific performance and damages, in which case the buyer asks that the seller pay for any costs and hardships suffered by the buyer as a result of the seller's breach in addition to forcing the seller to sell the property to the buyer.
- Alternatively, the buyer may *rescind* (cancel) the contract and the seller must return any earnest money deposit.

### **Buyer Breach**

If the buyer defaults:

- the seller can sue for damages
- sue for the purchase price in exchange for a deed (similar to specific performance for a buyer).
- the seller may declare the contract forfeited. In this case, the contract usually permits the seller to retain the buyer's earnest money as *liquidated damages*.
- the seller may sue for *compensatory damages* if the buyer's breach resulted in further financial losses for the seller.

The contract may limit the remedies available to the parties. **A *liquidated damages clause* permits the seller to keep the earnest money deposit and any other payments received from the buyer as the seller's sole remedy**.

### **Statute of limitations**

**In Illinois, the statute of limitations for oral contracts is five years; for written contracts, ten years. Any rights not enforced within the applicable time period are lost.**

### **Other Reasons for Termination**

Contracts may also be discharged or terminated when any of the following occurs:

- **Partial performance** of the terms, along with a written acceptance by the other party

- **Substantial performance**, in which one party has substantially performed on the contract but does not complete all the details exactly as the contract requires (Such performance may be enough to force payment, with certain adjustments for any damages suffered by the other party). For instance, if a newly constructed addition to a home was finished except for polishing the brass doorknobs, the contractor would be entitled to the final payment.
- **Impossibility of performance**, in which an act required by the contract cannot be legally accomplished
- **Mutual agreement** of the parties to cancel
- **Operation of law** such as in the voiding of a contract by a minor, as a result of fraud, due to the expiration of the statute of limitations, or because a contract was altered without the written consent of all parties involved
- **Rescission** one party may cancel or terminate the contract as if it had never been made. Cancellation terminates a contract without a return to the original position. Rescission, however, returns the parties to their original positions before the contract, so any monies that have been exchanged must be returned. Rescission is normally a contractual remedy for a breach, but a contract may also be rescinded by the mutual agreement of the parties.

## **TERMINATION OF CONTRACT – GETTING ESCROW BACK TO BUYERS**

Sometimes a sales contract can be cancelled by either party as long as it's done within the attorney's approval or inspection approval period. If the sales contract is terminated by agreement of both parties of the contract, then the earnest money placed by the buyer must be returned.

If there is a dispute on releasing the earnest money, the sponsoring broker should maintain the funds until both parties agree in writing on how to proceed. The escrow moneys must be disbursed according to the terms for the required release. This release of escrow funds must be signed by all parties to the purchase contract.

If the release of the escrow funds is contested by any of the parties, the sponsoring broker must continue to hold the earnest money and try to resolve the issue.

If the parties cannot come to an agreement for release of escrow funds within 6 months, the sponsoring broker must absolve themselves and turn the escrow amount over to the Illinois State Treasurer.

## **CONTRACTS USED IN THE REAL ESTATE BUSINESS**

### **Background**

For many years, all real estate contracts were in paper form, and various laws and customs dictated that most Real Estate Contracts had to be written (hard copies or paper copies) to be valid or enforceable in court (See Agency).

However, our technology advancements have progressed to the point that we can transmit documents over the internet, and more recently, interact with these electronic documents. One of the interactions allows us to edit or change these electronic documents. This, of course has led to the ability to initial, change, and sign Real Estate Contracts.

The original Real Estate Licensing Law that required the buyer and seller to be given original hard copies of the signed and executed contract presumed the use of paper or a hard copy format is still on the books. But Illinois has also recognized the digital world and passed a law-making digital documents and electronic signatures/initials legal.

**The Illinois State law, The Uniform Electronic Transaction Act (UTEA), passed in 1999 also recognizes electronic signatures as legally binding – i.e., handwritten and electronic signatures (e-signatures) are equally legal forms of signatures. Additionally, the legality of the electronic form of real estate contracts (e-real estate contracts) was also confirmed.**

### **Electronic Signatures For Contracts/Documents**

The use of electronic signatures has been a topic of discussion and laws (Federal and State) for many years. A Federal law covering this subject was also passed in 2000, the Electronic Signatures in Global and National Commerce Act (ESIGN) recognizes electronic signatures as legally binding in business transactions.

### **Difference Between E-Signatures (Electronic Signatures) And Digital Signatures**

When discussing the differences between eSignature and Digital signature, organizations typically refer to E-Signature as the process a person goes through to demonstrate their intent during an electronic transaction. While a digital signature refers to the encryption technology containing critical metadata pertaining to the e-signature. In this case, the e-signature is the legally binding record and the digital signature is the underlying technology that helps verify the authenticity of the transaction. Both digital signatures and other electronic signature solutions offer the capability to sign and authenticate the signer. However, they differ in their purpose, underlying technologies, geographical use, and as mentioned before, legal, and cultural acceptance

### **Problems With E-Signatures (Electronic Signatures) And Real Estate Contracts**

However, several significant questions remain concerning e-real estate contracts and e-signatures. First, how do you prove that the e-signatures are the real signatures of the parties to the contract (buyers/sellers/landlords/tenants)? Secondly, how do you prove that the e-real estate contract contains exactly the same language agreed upon by the parties when they signed the contract utilizing an e-signature? Obviously, if there is good will between the buyer/seller or landlord/tenant, this issue may not be important. **Where there is NOT good will between the parties, either currently or sometime in the future (buyer's remorse, seller's remorse, landlord remorse, tenant remorse) or other problems, and the electronic content of the document is challenged or the electronic signature is challenged, there could be a serious problem.** For instance, one of the parties could claim that the e-real estate contract has been **modified since their e-signature was attached to the document.**

### **E-Signature And E-Contract Verification**

Several options are available:

1. The first option would be to simply explain to the parties and ascertain if they are willing to accept that the e-real estate contract and e-signatures will be valid unless somebody objects to the signatures or contract. **If such an objection is received it may be difficult to prove**



**the validity of the e-signatures or the content of an e-real estate contract as it existed at the time of those e-signatures.**

2. The second option would be to follow the procedures provided for under Illinois law for the establishment of a "secure electronic signature" and a "secure electronic record." This involves the process of using a digital signature or e-signature using an asymmetric algorithm certified by the Secretary of State as a qualified security procedure. However, this process seems to present hurdles or roadblocks which are difficult to overcome in the context of the transaction.
3. The third option is for the parties to the transaction to agree to a qualified security procedure in advance of the signing of an e-real estate contract. This qualified security procedure must be commercially reasonable under the circumstances, applied in a trustworthy manner and is reasonably and in good faith relied upon by the party wanting to enforce the secure electronic record (the e-real estate contract).

This third option is now being used by many real estate firms and brokers in Illinois. DocuSign is an example of a process that provides tracking and security of the electronic form of the real estate contract to assure that each party to the contract is aware of changes as they are made. Where final E-Signatures are obtained for the contract, a record of the information agreed to at that time is also maintained to protect against information being added after the parties electronically sign the document. Additionally, there are procedures in place in the DocuSign operation to assure the validity of the signatures utilized in the electronic document. All of these operations combine to provide a legal E-Signature use and E-Real Estate Contract use in Illinois real estate transactions.

The written/electronic agreements most commonly used by brokers and managing brokers are:

- listing agreements and buyer agency agreements,
- real estate sales contracts,
- options agreements,
- escrow agreements,
- leases, and
- land contracts or contracts for deed.

### **Quinlan & Tyson Decision**

The 1966 Illinois Supreme Court decision in the case of *Chicago Bar Association, et al. v. Quinlan and Tyson, Inc.*, placed certain **limitations on real estate licensees in drafting a contract of sale.**

The court ruled that:

- Licensees can **only use standard (pre-printed or digital) form contracts that are customarily used in the real estate community**
- Licensees are **authorized only to fill in blanks on pre-printed or digital form contracts.** Where **no information is required for a blank space**, the Licensee should **insert NA or a line through the unused blank.** It is a **violation of Licensing Law** to **leave blank spaces in a signed contract (either pre-printed or digital).**
- Licensees are **authorized only to line out wording which is not applicable to the pre-printed or digital contract**, such as alternative financing arrangements.

Real estate sales contracts that fit the "customarily used" requirement typically have been drafted by local bar associations and approved by the local REALTOR® associations. They are available in digital form, for use with digital systems such as DocuSign, or can be printed out for hard copy use.

**All insertions and deletions must be at the direction of the *principals*, based on the negotiations. Advising a buyer or seller of the legal significance of any part of the contract or writing any change to the form language constitutes the unauthorized practice of law.**

A licensee may not request or encourage a party to sign a contract or document that contains blank spaces to be "filled in later," **nor can the licensee make changes to a signed contract without the written consent of the parties. If changes are made by the agreement of all the principals, the buyers and sellers must initial any changes they agree to add.** All licensees can **give each person signing or initialing the contract an original "true copy" (signed hard copy) or forward a copy of the electronically edited, initialed, and signed electronic version of the contract to the buyer and seller, within 24 hours of the time of signing.**

**A licensee also must not prepare or complete any document subsequent to the sales contract or related to its implementation, such as a deed, bill of sale, affidavit of title, note, mortgage, or other legal instrument.**

## LISTING AND BUYER AGENCY AGREEMENTS

**Listing and buyer agency agreements are employment contracts.**

A **listing agreement** establishes the rights and obligations of the **sponsoring broker as agent and the seller as principal.**

A **buyer agency agreement** establishes the relationship between a buyer as principal and sponsoring broker as agent.

## Customary Terms of Real Estate Sales Contracts

A real estate sales contract contains the complete agreement between the buyer of a parcel of real estate and the seller. Depending on the area, this agreement may be known as an offer to purchase, a contract of purchase and sale, a purchase agreement, an earnest money agreement, a deposit receipt, or a sales contract.

**In Illinois, a licensee should not use any form titled "Offer to Purchase" if the form is intended to become a binding real estate contract. Illinois law requires that sales contracts indicate at the top "Real Estate Sales Contract" in bold type.**

The *contract of sale* is the most important document in the sale of real estate. It establishes the legal rights and obligations of the buyer and seller. In effect, it dictates the contents of the deed.

## Parts of a sales contract

All real estate sales contracts can be divided into a number of separate parts. Although each form of contract contains these divisions, their location within a particular contract may vary. Most sales contracts include the following information:

- The purchaser's name and a statement of the purchaser's obligation to purchase the property, including how the purchaser intends to take title
- An adequate description of the property, such as the street address
- The seller's name and a statement of the type of deed a seller agrees to give, including any covenants, conditions, and restrictions that apply to the deed
- The purchase price and how the purchaser intends to pay for the property, including earnest money deposits, additional cash from the purchaser, and the conditions of any mortgage financing the purchaser intends to obtain or assume
- The amount and form of the down payment or earnest money deposit and whether it will be in the form of a check or promissory note
- A provision for the closing of the transaction and the transfer of possession of the property to the purchaser by a specific date
- A provision for title evidence (abstract and legal opinion, certificate of title, or title insurance policy)
- The method by which real estate taxes, rents, fuel costs, and other expenses are to be prorated
- A provision for the completion of the contract should the property be damaged or destroyed between the time of signing and the closing date
- A liquidated damages clause, a right-to-sue provision, or another statement of remedies available in the event of default
- Contingency clauses (such as the buyer's obtaining financing or selling a currently owned property or the seller's acquisition of another desired property or clearing of the title; attorney approval and home inspection are other commonly included contingencies)
- The dated signatures of all parties (the signature of a witness is not essential to a valid contract)—In some states, the seller's non-owning spouse may be required to release potential marital or homestead rights. An agent may sign for a principal if the agent has been expressly authorized to do so. When sellers are co-owners, all must sign if the entire ownership is being transferred.
- **In Illinois, commission is now paid as follows: “The real estate brokers named in this Contract shall be compensated in accordance with their agreements with their clients and/or any offer of compensation made by the listing broker in a multiple listing service in which the listing and cooperating broker participate.”**

## Additional provisions

Many sales contracts provide for the following:

- Any personal property to be left with the premises for the purchaser (such as major appliances or lawn and garden equipment)
- Any real property to be removed by the seller before the closing (such as a storage shed)
- The transfer of any applicable warranties on items such as heating and cooling systems or built-in appliances
- The identification of any leased equipment that must be transferred to the purchaser or returned to the lessor (such as security systems, cable television boxes, and water softeners)

- The appointment of a closing or settlement agent
- Closing or settlement instructions
- The transfer of any impound or escrow account funds
- The transfer or payment of any outstanding special assessments
- The purchaser's right to inspect the property shortly before the closing or settlement (often called the walk-through)
- The agreement as to what documents will be provided by each party and when and where they will be delivered

The sale of a residence often includes personal property, such as drapes, as well as items that are fixtures, such as screens and storm windows or a built-in range. In Illinois, any fixtures that might be questioned as fixtures are listed in the sales contract. This can help to eliminate possible arguments at the time of the final walk-through. Even attached bookcases and sometimes shrubbery have managed to disappear if they are not listed. Title to personal property usually is transferred by a *bill of sale*, prepared by the attorney.

### **Earnest money deposits**

It is customary (although not legally required) for a purchaser to provide a deposit when making an offer to purchase real estate. This deposit, usually in the form of a check, is referred to as earnest money. The earnest money deposit is evidence of the buyer's intention to carry out the terms of the contract in good faith. Usually, the check is given to the listing sponsoring broker, who holds it for the parties in a special account. If the offer is not accepted, the earnest money deposit is returned immediately to the would-be buyer.

The amount of the deposit is a matter to be agreed on by the parties. Under the terms of most listing agreements, the sponsoring broker is required to accept a "reasonable amount" as earnest money. The deposit should be an amount sufficient to:

- discourage the buyer from defaulting,
- help the seller feel comfortable in taking the property off the market, and
- cover any expenses the seller might incur if the buyer defaults.

**Many contracts provide that the deposit becomes the seller's property as liquidated damages if the buyer defaults. To release earnest money in Illinois, for any reason, signatures of both parties are required.**

Sponsoring brokers who are holding earnest money deposits in sales and security deposits in leasing must establish special trust (or escrow) accounts for the deposit of funds entrusted to them in connection with real estate transactions. A sponsoring broker need not open a special escrow account for *each* earnest money deposit received, however, but may deposit all earnest money funds in one account. The escrow account is noninterest bearing, unless both parties agree in writing. If interest is paid on the deposit, the disposition of any accrued interest must be designated by the parties in writing, and a separate interest-bearing account must be set up for that deposit.

## Escrow Account

See Chapter 16, Illinois Real Estate Licensing Law, for more information about Escrow Accounts.

Each sponsoring broker who utilizes an escrow account to hold Earnest Money Deposits:

- must maintain a complete journal and ledger of all earnest money transactions and a Log of all escrow accounts
- notify the IDFPR of the name of the federally insured institution where the money is deposited.
- All funds must be deposited in escrow accounts no later than the end of the next business day following the acceptance of the real estate contract or lease agreement.
- Both the account itself and sponsoring broker records are subject to inspection at any time.
- Sponsoring broker records need to be produced within 24 hours upon official request
- Escrow reconciliations must be completed within ten days after receipt of the monthly bank statement
- Escrow Account documents must be kept for a minimum of five years.

**Only the sponsoring broker or an authorized agent may withdraw funds from the account.** Fees and/or commissions earned by the sponsoring broker that are to be paid from the funds in this account are to be **disbursed by the sponsoring broker from the account no earlier than the day the transaction is consummated** or terminated and **no later than the next business day after consummation** or termination of *the transaction*.

## Commingling

Sponsoring brokers are **strictly prohibited from commingling**, that is, **depositing earnest money in their personal or corporate operating account**. The **very act of depositing earnest money in these accounts** constitutes a **violation of Real Estate Licensing Law**. Sponsoring Brokers may deposit funds into the Escrow Account for the purpose of maintaining a minimum running balance required by the depository or to pay for checks. If a sponsoring broker uses his own funds to avoid incurring service charges, scrupulous records must be kept.

## Conversion

Conversion involves the **use of the escrow funds to pay for personal or business expenses**. This is also a violation of Real Estate Licensing Law.

## Equitable title

When a buyer signs a contract to purchase real estate, the buyer does not receive legal title to the land. Legal title transfers only on delivery and acceptance of a deed. However, **after both buyer and seller have executed a sales contract, the buyer acquires an interest in the land**. This interest is known as **equitable title**. **Equitable title** may give the buyer an insurable interest in the property.

## Destruction of the premises

Illinois has adopted the **Uniform Vendor and Purchaser Risk Act**, which specifically states that the **seller bears any loss that occurs before the title passes** or the buyer takes possession.

If the **entire premises or a material part of it is destroyed**, the seller cannot enforce the contract against the buyer. Any earnest money must be returned. On the other hand, if title or possession has been transferred to the buyer, he must pay the full contract price, even in the event of partially or totally destroyed premises (e.g., the house burns while both parties are at the closing).

### Liquidated damages

To avoid a lawsuit if the buyer breaches the contract, the parties may agree on a certain amount of money that will compensate the seller. That money is called liquidated damages. If a sales contract specifies that the earnest money deposit is to serve as liquidated damages in case the buyer defaults, the **seller will be entitled to keep the deposit if the buyer refuses to perform without good reason**. The seller who keeps the deposit as liquidated damages may not sue for any further damages if the contract provides that the deposit is the seller's sole remedy.

### Contingencies

Additional conditions that must be satisfied before a sales contract is fully enforceable are called **contingencies**. A contingency includes the following three elements:

1. The specific actions necessary to satisfy the contingency
2. The time frame within which the actions must occur
3. Who is responsible for paying any costs involved?

**The most common contingencies include:**

- **Mortgage contingency**- The buyer's earnest money is protected until a lender commits the mortgage loan funds. (This is sometimes called a financing contingency).
- **Inspection contingency** - A sales contract may be contingent on the buyer obtaining certain inspections of the property within a set time frame. Inspections may include a basic home inspection or special inspections for radon, wood-boring insects, lead-based paint, structural and mechanical systems, sewage facilities, or various toxic materials.
- **Property sale contingency** - Buyers may make the sales contract contingent on the sale of their current home by a certain date. This protects the buyer from owning two homes at **the** same time and also helps ensure the availability of cash for the purchase.

### Continue to Market a Signed Contract with Contingencies

A seller may insist on an **escape clause**, which **permits the seller to continue to market the property until all the buyer's contingencies have been satisfied or removed**. The buyer may retain the right to eliminate the contingencies if the seller receives a more favorable offer.

### Amendment and Addendum

An **amendment** is a change to an existing contract. For instance, the parties may agree to change a closing date or alter a list of personal property items included in the sale. Any time **words or provisions are added to or deleted from the body of the contract, the contract has been amended**. Amendments must be **signed or initialed by all parties**.

On the other hand, an **addendum** is any provision added to an existing contract without altering the content of the original. An addendum is essentially a new contract between the parties that includes the

original contract's provisions "by reference"; that is, the addendum mentions the original contract. An addendum must be signed by both parties.

**Amendment** = Change    **Addendum** = Addition

**Illinois requires several mandatory disclosures by sellers and licensees acting as their agents, such as disclosure of property conditions and agency relationships. These disclosures are included in the sales contract by physical attachment or by reference.**

## Options

An option is a contract by which an **optionor** (generally an owner) gives an **optionee** (a prospective purchaser or lessee) the right to buy or lease the owner's property at a fixed price within a certain period of time. The optionee pays a fee (agreed-on consideration) for this option right. The optionee has **no other obligation until he decides to either exercise the option right or allow the option to expire**. An **option is enforceable by only one party - the optionee**.

**An option contract is *not* a sales contract.** At the time the option is signed by the parties, the owner does not sell and the optionee does not buy. The parties merely agree that the **optionee has the right to buy and the owner is obligated to sell if the optionee decides to exercise his right of option**. Options must contain all the terms and provisions required for a valid contract.

**The option agreement is a *unilateral contract*. If the option is not exercised within the time specified in the contract, both the optionor's obligation and the optionee's right expire.** An option contract may provide for renewal, which often requires additional consideration. The optionee may recover part of the consideration paid for the option right if the optionee provides a decision prior to the expiration date. The contract may state whether the money paid for the option is to be applied to the purchase price of the real estate if the option is exercised.

## Land Contracts — Installment Contract (Seller Financing)

A real estate sale can be made by a **land contract**, also called a *contract for deed*, an **installment contract**, or *articles of agreement for warranty deed*. Under a typical land contract, the seller (also known as the *vendor*) retains legal title. The buyer (called the *vendee*) takes possession and gets **equitable title** to the property. The buyer agrees to give the seller a down payment and pay regular monthly installments of principal and interest over a number of years. The buyer also agrees to pay real estate taxes, insurance premiums, repairs, and upkeep on the property. Any provision in an installment contract or land contract is void if the document:

- forbids the contract buyer to record the contract,
- provides that recording shall not constitute notice, or
- provides any penalty for recording.

Any installment contract for the sale of a dwelling that consists of **12 or fewer units is voidable** at the option of the buyer unless either a certificate of compliance or an express warranty that **no notice of a building code violation has been received within the past ten years is attached to or incorporated into the contract**. If notice has been received within the past ten years and not complied with, each notice must be listed with a detailed explanation. Neither buyer nor seller may waive this

requirement. A buyer who, under an installment contract, purchases residential property containing six or fewer units (which includes one unit in which the purchaser will reside) from a **land trust must be told the names of all beneficiaries of the trust at the time the contract is executed**. The buyer has the option to void the contract if the names are not revealed.

### **Parol Evidence Rule**

The written contract is assumed to be the complete agreement of the parties.



**NOTES:**

[illegible]

## CHAPTER 13: REAL ESTATE BROKERAGE OPERATIONS & AGREEMENTS

### REAL ESTATE BROKERAGE OPERATIONS

A **brokerage** business may take many forms. It may be a sole proprietorship (a single-owner company), a corporation, or a partnership. The office may be independent or part of a regional or national franchise. The business may consist of a single office or multiple branches. The brokerage office may be located in a downtown high rise, a suburban shopping center, or the sponsoring broker's home. A typical real estate brokerage may specialize in one kind of transaction or service, or it may offer a variety of services.

No matter what form it takes, a real estate brokerage has the same demands, expenses, and rewards as any other small business. A real estate broker faces many of the same challenges as an entrepreneur in any other industry. In addition to mastering the complexities of real estate transactions, the **real estate broker must be able to handle the day-to-day details of running a business and to set effective policies for every aspect of the brokerage operation.** This includes maintaining space and equipment, hiring employees and real estate licensees, determining compensation, directing staff and sales activities, and implementing procedures to follow in carrying out agency duties. Each state's real estate license laws and regulations establish the business activities and methods of doing business that are permitted.

### Virtual Brokerage Offices

A virtual brokerage office offers the same capacity of the traditional brick and mortar office. Because of access to the internet and mobile-friendly devices and available apps, licensed agents can conduct a transaction from anywhere that the agent or consumer is located. An agent or client does not need to come into the office to conduct their business.

### THE MANAGING BROKER AND SPONSORING BROKER

The Act creates a new classification of managing broker. A “designated managing broker” is a managing broker appointed by the sponsoring broker who has supervisory responsibilities for licensees in one or multiple offices. **225 ILCS 454 Section 1-10.** In Illinois, every real estate office must have a sponsoring broker or designated managing broker of record, neither of which is required to be the owner of the business. **All licensees acting as a designated managing broker or self-sponsored broker must have a managing broker's license.**

A designated managing broker has **taken additional courses and received a managing broker license.** A sponsoring broker may also be the designated managing broker of an office or may appoint a managing broker to serve as the designated managing broker of several offices, or different designated managing brokers may be responsible for an individual office as long as it is for the same sponsoring broker. In any event, the designated managing broker is responsible for the supervision of all real estate activities performed by affiliated licensees.

## **Designated Managing Broker Responsibility and Supervision**

Designated managing broker's responsibilities include:

- Supervision and training of all licensees and employees associated with each assigned office;
- Implementing company policies; and
- Supervision of all the sponsoring broker's special accounts. **225 ILCS 454 Section 10-55(a)**

In addition, designated managing brokers shall directly handle all earnest money, escrows, contract negotiations, and advertisements for broker who have not completed the 45-hour post-license education. **225 ILCS 454 Section 10-55(b)**

A designated managing broker may be disciplined for failure to provide a written company policy or perform any of the duties set forth in **Section 10-55. 225 ILCS 454 Section 20-20(a)(46)**

A designated managing broker shall be responsible for the supervision of all licensees associated with a designated managing broker's office. A designated managing broker's responsibilities include implementation of company policies, the training of licensees and other employees on the company's policies as well as on relevant provisions of this Act and providing assistance to all licensees in real estate transactions. The designated managing broker shall be responsible for, and shall supervise, all special accounts of the company.

## **Maintenance of licenses**

Sponsoring brokers are required to notify IDFPR in writing of the names and license numbers of all designated managing brokers employed by the sponsoring broker and the office or branch offices for which each designated managing broker is responsible. The designated managing broker must have a current active managing broker's license.

## **Supervision**

The Designated Managing Broker supervises all brokers and also unlicensed assistants working in those offices managed by the designated managing broker. These supervisory duties include the following:

- Implementation of office policies and procedures established by the sponsoring broker
- Training of licensees or unlicensed assistants
- Assisting licensees as necessary in real estate transactions
- Supervising escrow accounts over which the sponsoring broker has delegated responsibility to the designated managing broker in order to ensure compliance with the escrow account provisions of the Act
- Supervising all advertising of any service for which a license is required
- Familiarizing sponsored licensees with the requirements of federal and state laws relating to the practice of real estate
- Compliance with the rules for licensees and offices under his supervision

## Sponsoring Brokers

By Section 1450.100 definition, **the sponsoring broker is the entity holding the company real estate license**, whether the entity is an **individual** who operates as a sole proprietorship, **partnership**, **limited liability company**, **corporation**, or registered **limited liability partnership**.

- A sponsoring broker may be **self-sponsored**.
- There may be only one sponsoring broker for any one real estate company.
- A sponsoring broker may authorize a designated managing broker to issue a license in the name of the sponsoring broker.

Likewise, the sponsoring broker may assign escrow account bookkeeping duties to a qualified company employee or independent contractor and may delegate authorized individuals to sign on behalf of the sponsoring broker. The sponsoring broker may authorize company personnel to sign contracts entered into by the sponsoring broker according to the sponsoring broker's company policy. Even though the sponsoring broker may delegate authority, ultimately, the sponsoring broker is responsible for all activities.

The sponsoring broker is responsible for supervising all designated managing brokers, shall name a designated managing broker for each office, and notify the Department of all designated managing brokers and the office(s) they manage. **225 ILCS 454 Section 5-45(b)**

The sponsoring broker is ultimately responsible for the actions of **all** sponsored licensees including those of designated managing brokers as well as proper maintenance of escrow funds.

## Advertising

Effective August 9, 2019, **all designated managing broker licensees** who are named as designated managing brokers with the Division **must indicate this status on all advertising that includes their name**. Those who **hold the managing broker license but are not named as designated managing broker with the Division, are not required to include their managing broker status**. **All licensees who have a managing broker's license may indicate that they are managing brokers on all advertisements.**

## Planning

Planning is the most fundamental management activity. **Almost every business decision is guided by a business plan**. Planning takes time and money; however, the resources devoted to planning are relatively small in comparison to the benefits of a sound plan that is followed and reviewed often. It is useful for building credibility with others outside your company. For the plan to be effective, it must be flexible and measurable, but, most important, it must be achievable.

The development of the business plan begins with creating a **mission statement**. Everything else in the business plan supports the mission statement. The mission statement identifies **specific objectives or goals** for accomplishing the mission. These are the end results to be achieved. Goals have several characteristics. They must:

- be specific or identifiable,
- be measurable,

- be attainable, and
- have beginning and ending dates.

Each of the goals is supported by **strategies** that prescribe the methodology used in accomplishing that specific goal. **Strategies include things needing to be done to overcome any obstacles or enhancement of resources.**

### **Preparing a Policy and Procedures Manual**

A **policy and procedures manual** should be written and should serve as a risk management tool for the company. Policies and procedures are extremely beneficial for the following reasons:

- Establishing a clear understanding of the relationship between broker and sponsored licensees as well as administrative functions versus staff functions
- Working to resolve conflicts before they come up
- Building confidence that everyone knows what the rules are and how the company is supposed to operate
- Giving guidance for many of the situations licensees face on a day-to-day basis.

Keep in mind that the **policy and procedures manual is not a sales training manual.**

### **Safety Concerns: Appointments and Showings**

Many real estate firms have responded to the violence by **incorporating safety procedures into their procedure manual** as a way to help keep their agents safe. Licensees can help minimize risks by implementing the following suggestions:

- Ask the customer for work, home, and cell phone numbers and a physical address. Verify the information by calling the customer at one or more of the numbers.
- Give someone in your office an itinerary of properties you plan to show and then check back in often by cell phone.
- Do not meet unknown customers at a property. Require that they meet you at your office. Make sure someone writes down their license plate number and the type of car they are driving.
- Never get into a car with someone you don't know. Use your vehicle for showings or ask your customer to follow you in another car.
- Program your cell phone to dial 911 at the touch of a button.
- Never work at a public open house by yourself.
- Do not show vacant properties by yourself unless you know your customers, and never show properties after dark.
- Keep pepper spray or Mace® handy.
- Always follow the customers into the property and let them enter while you stay by the door.
- Pay attention to exits.
- Ask someone else to accompany you to show or list property if you feel uncomfortable about the people with whom you are working.
- Don't assume that women are safer customers than men. Women are as just as capable of armed robbery and sometimes work with a partner who waits at the house for the two of you to arrive.

### Business Planning

To stay on top of changes in the real estate industry and practice, as well as keeping up with emerging technologies, brokers should review and update policy manuals regularly.

The Real Estate License Act of 2000 Section 10-40 requires that **"every brokerage company or entity, other than a sole proprietorship with no other sponsored licensees, shall adopt a company or office policy dealing with topics"** such as:

- the agency policy of the entity,
- fair housing, nondiscrimination, and harassment,
- confidentiality of client information, and
- advertising.

### Unexpected Loss of Designated Managing Broker

If a sponsoring and/or designated managing broker dies or a designated managing broker leaves a branch office unexpectedly, a request may be made **to IDFPR within 15 days of this development to grant an extension** for continued office operations. The **extension may be granted for up to 60 days**. In the case of an owner's death, a representative of the estate could operate the office for up to 60 days. In most cases of loss of a sponsoring broker or designated managing broker, a licensed designated managing broker assumes the management of the office.

### Death of Self-Sponsored Broker

IDFPR will honor the order of a court of competent jurisdiction appointing a legal representative for the sole purpose of closing out the affairs of a deceased or disabled broker who was a sole proprietor. The court order is honored until the real estate brokerage operation is closed but does not allow the brokerage to actively engage in the brokerage business.

### Change of Business Address

All designated managing brokers must notify IDFPR on business letterhead of any change of business address for any of the offices they manage **within 24 hours of any change**. Change of address filing is required for all offices and branch offices.

Additionally, each **designated managing broker**:

- is responsible for record-keeping as mandated by **Rule 1450.180**,
- is responsible for the maintenance of the employment agreements entered into with each sponsored licensee (**Rule 1450.160**), and
- if escrow monies are maintained, the designated managing broker must comply with each part of **Rule 1450.155**.

### ERRORS AND OMISSIONS INSURANCE

Sponsoring broker or designated managing brokers have an array of issues and options to consider when deciding to obtain an **errors and omissions insurance (E & O) policy**. In general, they need to determine what level of protection to seek in the policy and how to tailor the coverage to their sponsoring/managing practice. Because insurance policies and practices vary from company to company, the sponsoring broker or designated managing broker must be careful to review any specific

policy intended for the office and should discuss coverage with more than one insurance provider before obtaining coverage.

**The classes of services performed by licensees shape the types of liability claims most often filed against real estate licensees.** Real estate licensees may represent buyers, sellers, lessors, and lessees. They coordinate a variety of services, such as insurance, title, loan origination, home inspection, and legal review of contracts. In addition, they often function as independent professionals managing their own offices, advertising campaigns, and other related business functions. In providing these services, licensees become vulnerable to potential liabilities.

Liability claims can also arise from a number of related services provided occasionally for a separate fee basis or are incidental to the transaction. These include property appraisal, property management, auctioneering, consulting, and handling earnest monies or security deposits.

The most common errors and omissions claims against real estate licensees include the following:

- Mishandling monies (earnest money or security deposits) during transactions
- Making misstatements about material facts regarding the property, such as the presence of lead-based paint, asbestos, or radon
- Misrepresenting the property dimensions or failure to measure property dimensions accurately
- Disclosure of confidential information without authorization from the client
- Undisclosed dual agency
- Failure to identify the real or personal property correctly in the contract
- Mistakes regarding the property tax identification number (PIN) for the subject property or failure to provide an adequate legal description of the property
- Misrepresentations about financing arrangements
- Failure to disclose a financial interest in the customer who is negotiating with the client
- Failure to disclose financial relationships compensating the licensee in the transaction
- Violations of the federal Fair Housing Act and the Illinois Human Rights Act
- Breaching the terms of the listing or buyer agreement or the property management agreement

### **Policy Protection and Covered Services**

A real estate licensee needs insurance protection from claims made by clients, customers, and consumers related to the provision of real estate activities, referred to as professional services by the insurance industry. The sponsoring/ designated managing broker must determine whether the errors and omissions policy adequately addresses what:

- services are covered,
- person(s) is(are) covered,
- damages are covered,
- defenses are covered, and
- territory is covered.

Real estate licensees should know whether the services they provide constitute professional services and are, thus, insurable under the policy. They should also be aware that professional services are defined differently in each insurer's policy.

**Professional real estate services typically refer to services that require a person to have an Illinois real estate license in order to perform those services on behalf of clients, customers, and consumers.** As a prerequisite for coverage, the **licensee must possess all valid necessary licenses or certifications at the time of the act or omission giving rise to the claim and must be acting within the scope of the employment agreement**, either written or oral. Sometimes insurance companies will include coverage for ancillary professional real estate services rendered by the insured for others, such as a notary public's duties.

### **Covered Defense Costs**

**Errors and omission policies may sometimes pay the costs involved in investigating, defending, and settling claims. These costs primarily involve attorney's fees but also include related expenses required by the claim settlement process.** The sponsoring broker should determine whether defense costs are covered by the policy or in addition to the policy limits. If defense costs are covered within the policy limits, then as the legal fees increase, the limits of the coverage of the policy are proportionately reduced.

### **Excluded Coverage**

Most E & O policies **exclude certain ancillary real estate related activities.** These exclusions include a licensee's involvement in areas that do not require an Illinois real estate license, such as property development and insurance agency operations.

Depending on the insurer, coverage for such services may be bought back for an additional premium, if an insured's operations require such coverage. A real estate licensee who wants coverage for such services may obtain it by paying an additional premium or, depending on the limitations of the policy, by obtaining a separate policy. **The sponsoring broker or designated managing broker should also be aware that violations of fair housing laws, some civil sanctions, and criminal act are not covered by E & O policies.** Some policies will cover the legal defense for certain issues, such as discrimination, but not the damages awarded.

Other possible exclusions from coverage under E & O policies include the following:

- Bankruptcy of the insured
- Violation of securities law
- Wrongful termination
- Employee Retirement Income Security Act (ERISA) violations
- Claims by or against related entities
- Workers' compensation claims
- Claims arising from usage of vehicles, aircraft, and watercraft
- Environmental issues, such as mold and asbestos
- Real estate owned by the insured
- Commission disputes

### **Covered Persons**

E & O policies are intended to **cover those licensees whose licenses are held by the sponsoring broker, as well as office staff and unlicensed assistants in an insured real estate broker's office**



**who may be involved in a transaction—even if their function does not involve professional activities.** Where the sponsoring broker is a business entity, such as a partnership, corporation, or limited liability company (LLC), these policies can include coverage for past and present partners, officers, directors, and regular employees.

### **Independent Contractors**

Most real estate offices that sell residential real estate will sponsor licensees who are treated as independent contractors. Therefore, it is **important that the E & O policies cover those independent contractors.** The sponsoring/designated managing broker must keep in mind that unlicensed assistants cannot be treated as independent contractors because it is a violation of federal tax law. Therefore, the sponsoring/ designated managing broker must be certain that the E & O policy is written to cover unlicensed assistants. A sponsoring broker must also address liability arising from predecessor firm issues.

**Because there can be coverage gaps between E & O policies and commercial general liability (CGL) policies, the sponsoring/designated managing broker should ensure that excluded coverage for bodily injury, property damage, and personal injury are covered by CGL policies or by special endorsement.** Potential gap coverage between E & O policies and CGL policies should be discussed by the sponsoring broker with the insurer to best customize the coverage to the brokerage firm.

### **Covered Territory**

**Most E & O policies cover claims resulting from anywhere in the world, provided the claim and concomitant litigation is brought in the United States, its territories or possessions, or Canada.** Actions conducted outside the United States will likely require additional coverage or a separate policy. **The licensee should be aware that use of Websites with their worldwide exposure might lead to claims and litigation outside the United States; a licensee would need a policy with unrestricted territorial coverage to address this issue.**

### **Other Policy Issues**

The sponsoring broker or designated managing broker should be aware of additional issues that might affect E & O coverage. The insurance claims process varies from insurer to insurer. Therefore, licensees need to understand the procedures of their provider. Some policy issues to be aware of include the following:

- Most E & O policies have **liability caps** that set a payment limit per claim and an aggregate payment limit; the licensee should obtain coverage that matches the licensee's liability exposure.
- There are two basic types of deductible provisions. One type of **deductible applies to each error committed**, and the **other type applies to each claim filed.**
- Most E & O policies have provisions that **limit payment to the amount offered in a settlement offer.**
- All E & O policies have some **additional conditions that are essential elements of the policy's coverage.**
- Problems may arise when one insured sues another insured.

- Although most insurers limit coverage to the inception date of the policy, **some insurers will consider providing first-time insurance buyers coverage for prior acts** (for an additional premium).

It is the duty of the sponsoring broker to determine what level of E & O insurance is necessary to meet the needs of the brokerage office.

## SPONSORED LICENSEES

**Article 5, Section 5-26 of the Real Estate License Act of 2000**, states that "no new salesperson licenses shall be issued after April 30, 2011, and all existing salesperson licenses shall terminate on May 1, 2012." After April 30, 2012, only two types of licenses will be issued: **broker and managing broker. Both brokers and managing brokers can work under the supervision of a sponsoring broker.** A sponsoring broker may assign supervisory responsibilities to a designated managing broker.

## Independent contractor versus employee

Every sponsoring broker who hires licensees or has an **independent contractor relationship** with a licensee must have a **written employment agreement** with each licensee. The agreement defines the employment or independent contractor relationship, including supervision, duties, compensation, and termination. The employment agreement must be dated and signed by both parties. Termination is not intended to indicate that a specific termination date is required but rather allows for negotiation as to the term of the employment agreement. An executed copy of the employment agreement must be provided to the sponsored licensees.

### Independent Contractors:

- No Benefits
- No withholding of taxes
- *What **not** how*
  - Do not work employer-determined hours
  - Must be self-starters
  - Decide when and how to do their work
  - Paid only Commission; in some cases, expenses are taken out of commission

### Employees:

- Benefits
- Withholding of taxes
- *How **not** What*
  - Required work hours
  - Required attendance at sales meeting
  - Required training

A sponsoring broker's relationship with a sponsored licensee who is an **independent contractor** is very different. A licensee must meet three specific criteria set out by the IRS in the Internal Revenue

Code to be treated as an independent contractor for federal tax purposes, the following criteria must be met:

- Individual must hold an active real estate license
- Individual must agree in writing **not** to be treated as an employee for federal tax purposes
- At least 90 percent of the individual's income must be derived from sales rather than hours worked

An employment agreement between the sponsoring broker and designated managing broker is also required even if the designated managing broker is the sole owner in the sponsoring brokerage (regardless of the business type: LLC, LLP, and so on).

A sponsoring broker's relationship with a licensee who is an independent contractor can be very different from the relationship with an employee. As the name implies, independent contractors usually have a more flexible work schedule than that of employees. A broker may determine what the independent contractors do (especially because the contractors represent the broker as the broker's agents) but cannot dictate how they do it. As such, a company can expect independent contractors to comply with its policies and procedures. An independent contractor's income is typically commission-based. Independent contractors are responsible for paying their own income taxes and Social Security taxes.

### **Assistants**

An **assistant**, also known as a **real estate assistant** or **professional assistant**, is often a **combination office manager, marketer, organizer, and facilitator** with a fundamental understanding of the real estate industry. While an **assistant does not need to have a real estate license**, (s)he is **allowed to perform many more duties if holding a real estate license. (In Illinois, there is no specific assistant's license).**

#### **An unlicensed assistant's duties might include:**

- clerical functions,
- secretarial functions,
- answering phones.

#### **A licensed broker working as an assistant can:**

- set up and host open houses,
- deal more extensively with clients,
- actively show houses,
- assist in all aspects of a real estate transaction.

In other words, a licensed broker working as an assistant can perform any activity that any licensee is permitted to perform. **Section 1450.165** of the administrative rules specifies the permitted activities in which an unlicensed real estate assistant may engage.

**The Real Estate License Act of 2000 requires that licensed brokers working as assistants must have an employment agreement with the sponsoring broker of the firm in which they are**

**working, even though they are, in practice, working for an affiliate licensee. The sponsoring broker must pay licensed brokers acting as assistants.**

## **Case Studies/Scenarios/Role-playing #2**

### *Managing Assistants*

Real estate broker Maria is a top producing agent with a large firm. She employs two assistants, one who is licensed broker (Martin) the other Mina is unlicensed. Martin, the broker, handles all of the showings, inspections, appraisals, etc. While Mina, the unlicensed assistant handles the paperwork and follow up with clients, attorneys, lenders, and other agents. While broker Maria and licensed assistant Martin were attending an all-day seminar. Mina received a call from a buyer who wanted to see one of Maria's listings that was on the market for a long time and ready to expire. The buyer was deciding on making an offer on Maria's listing or another property and wanted to see Maria's listing now. Mina couldn't reach Maria or Martin, and since Mina was very familiar with the property, she decided to assist the buyer. Mina met the buyer at the property and let the buyer inside. Mina never said anything to the buyer. The buyer was pleased with the property, and an offer was accepted by the seller.

How should broker Maria handle this situation?

- A. Broker Maria should immediately terminate Mina and let her sponsoring broker aware of what happened.
- B. Maria shouldn't say anything because the buyer and seller did agree on a purchase contract and everyone is pleased.
- C. Mina should have waited until she heard from broker Maria.
- D. Mina's actions resulted in a sale and she should be compensated for a job well done.

## **Termination of Sponsorship**

**Section 5-40 of the Act states, "When a licensee terminates his or her employment or association with a sponsoring broker or the employment is terminated by the sponsoring broker, the person or entity initiating the termination shall notify the Department, in a manner prescribed by the Department, of the termination within 24 hours. Failure to timely notify the Department of the termination shall subject the person or entity initiating the termination to discipline under Section 20-20 of this Act. The license of any licensee whose association with a sponsoring broker is terminated shall automatically become inactive immediately upon the termination, and the licensee shall not be authorized to practice until a new valid sponsorship is registered with the Department."**

- The licensee can terminate their license on their own.
- Once a licensee terminates their sponsorship with their sponsoring broker, their licenses become inactive until they find a new sponsoring.

## **TEAMS OF BROKERS**

**Illinois real estate laws do not currently define the concept of a team, although the laws that define activities that require a real estate license in Illinois apply to them. A licensed team**

member must have a **written employment contract/independent contractor agreement with the sponsoring broker.**

## Teams

Team - now defined team as any two or more licensees who work together to provide real estate brokerage services, represents themselves to the public as being a part of a team or group, are identified by a team name that is different than their sponsoring broker's name, and together are supervised by the same Designated Managing Broker and sponsored by the same Sponsoring Broker. "Team" does not mean a separate organized, incorporated, or legal entity. **Team advertising applies to all forms of advertising including all social media.**

List of words **NOT ALLOWED** to identify a team:

- Company
- Realty
- Real Estate
- Agency
- Associates
- Broker
- Property
- Properties

If ad content or team name includes the word "team" after verboten words, the team should be allowed.

- Size of a licensee or team name cannot be larger than that of the sponsoring broker company name
- URL/Domain names cannot be deceptive, cannot drive traffic
- One click away rule
  - Example samrealtor.com - one click away to Sam's team at ABC Real Estate is okay.
  - Company logo is not part of the company's legal name. The company name has to be as big Or bigger in font size (area, width, and height) as the team's name.



## Unlicensed team members are regular employees.

Either the sponsoring broker or a licensed team member might compensate them. The sponsoring broker will want to ensure that proper withholding requirements are met if a team member is compensating the regular employee.

Similarly, the use of an unlicensed assistant, whether or not a member of a team, must comply with the laws that determine who is an independent contractor. **By definition, the unlicensed assistant does**

**not meet the safe harbor provisions of an independent contractor and would likely need to be paid as a regular employee.**

### SPONSORING BROKER COMPENSATION - COMMISSION

The sponsoring broker's compensation is specified in the contract with the client. The amount of a broker's commission is negotiable in every case. Even subtle attempts to impose uniform commission rates are clearly a violation of antitrust laws. A sponsoring broker, however, may set the minimum commission rate acceptable for his own company.

### Commissions

**Only a licensed designated managing or sponsoring broker may collect a commission in Illinois.**

- The designated managing or sponsoring broker then may share it with any licensees who are directly involved in or responsible for a given transaction.
- To collect a commission on a real estate transaction, the agent must have been "hired" by way of an agreement in which the principal (seller or buyer) agreed to pay a specified commission for services.
- The percentage of sales price or dollar amount of commission must have been expressed clearly in the agreement.
- If another real estate office "brought in" the buyer, the concept of cooperative commission allows the seller *broker* to pay the *buyer* broker the amount of *cooperative commission* advertised in advance on the multiple listing service (MLS) listing.
- This commission check is issued by the listing broker's office to his own office and also to the buyer broker's office.
- Checks then are cut by each of these sponsoring brokers to any respective salespersons (or other brokers working within the firm) who were directly involved in the transaction.
- A commission is usually considered earned when the work for which the real estate broker was hired has been accomplished - seller and buyer have signed a sales contract.
- Although commissions are earned when the sales contract is signed, they are usually paid at closing.

Most sales commissions are payable when the sale is consummated by *delivery of the seller's deed*. This provision is generally included in the listing agreement. When the sales or listing agreement specifies no time for the payment of the broker's commission, the commission is usually earned when:

- a completed sales contract has been executed by a ready, willing, and able buyer,
- the contract has been accepted and executed by the seller, and
- copies of the contract are in possession by all parties.

To be entitled to a sales commission, an individual

- must be a licensed real estate broker,
- the procuring cause of the sale, and
- employed by the buyer or the seller under a valid contract.

To be considered the **procuring cause of a sale**, the broker must have started or **caused a chain of events that resulted in the sale**.

A broker who causes or **completes such an action without a contract** or without having been promised payment **is a volunteer and may not legally claim compensation**.

A ready, willing, and able buyer is one who:

- is prepared to buy on the seller's terms
- ready to take positive steps toward consummation of the transaction.

**Once a seller accepts an offer from a ready, willing, and able buyer, the real estate broker is entitled to a commission.**

**If the buyer or seller breach the contract, the real estate broker may still be entitled to a commission:**

- if the seller had a change of mind and refused to sell,
- has a spouse who refused to sign the deed,
- had a title with uncorrected defects,
- committed fraud with respect to the transaction,
- was unable to deliver possession within a reasonable time,
- insisted on terms not in the listing (e.g., the right to restrict the use of the property),
- had a mutual agreement with the buyer to cancel the transaction.

**In Illinois, the closing of the sale is the usual proof in a court of law that the broker has produced a buyer and earned a commission.**

### **Commission Structures**

**Commission "splits" earned by sponsored licensees vary.** Some firms have adopted a 100 percent commission plan. Sponsored licensees in these offices pay a monthly service charge or desk fee to their sponsoring brokers to cover the costs of office space, telephones, and supervision in return for keeping 100 percent of the commissions from the sales they negotiate. The 100 percent commission sponsored licensee pays all of his own expenses.

**Other companies offer graduated commission splits based on a sponsored licensee's achieving specified production goals.** No matter how the licensee's compensation package is structured, only the sponsoring broker can pay it.

In **cooperating transactions** (usually stated as "co-op: X% on the MLS sheet), the **commission is paid by the sponsoring broker of the "seller side" to the sponsoring broker of the "buyer side"**.

**If a sponsored licensee had earned a commission, but his employment had been terminated prior to the payment of the commission, the former sponsoring broker may pay the commission directly to the former associate, even if that former associate has a new sponsoring broker.**

### **Commissions and disclosures**

The sponsoring broker's compensation and policy with cooperating brokers who represent other parties in a transaction **must always be disclosed**. If there is compensation from two parties to a transaction from both the buyer and the seller **that needs to be disclosed in writing as well**.

If a licensee refers the client to another source for services related to the transaction and the licensee has an interest **greater than 1 percent in that source**, it must be disclosed. In addition, a licensee must disclose to a client all sources of compensation related to the transaction received by the licensee from a third party.

### **SALES FORCE COMPENSATION**

The amount of compensation a licensee receives from a sale is set by mutual agreement between the affiliated licensees and their sponsoring brokers. This compensation agreement is included in the employment agreement. Some sponsoring brokers require that licensees pay all or part of the expenses of advertising listed properties; this may be subtracted from commissions by agreement or be billed separately to the licensee.

In many states, including Illinois, it is illegal for a sponsoring broker to pay a commission to anyone other than:

- a licensee under that same sponsoring broker; or
- another firm's sponsoring broker (cooperative commission) who then pays his own sponsored licensees involved.

Fees, commissions, or other compensation **cannot be paid to unlicensed persons for services that legally require a real estate license**. "Other compensation" includes certain items of personal property, such as a new television, or other premiums, such as vacations, given to non-licensed persons to perhaps acquire names of "leads." This is not to be confused with referral fees paid between designated managing or sponsoring brokers for "leads," which are legal as long as the individuals are licensed.

Under the Act, a licensee may **form a solely owned business entity** for the purpose of receiving compensation. That one-shareholder corporation cannot be licensed by the IDFPR. However, the licensee must file a copy of the certificate of incorporation issued by the Secretary of State with IDFPR. The corporation can receive compensation earned by that **licensee only**, both from real estate and non-real estate-related activities. The corporation cannot be licensed and cannot be used by the licensee to perform real estate activities, sponsor, or employ other licensees, or advertise itself to the public in the corporation's name.

### **TECHNOLOGY AND BROKERAGE OF THE FUTURE**

Social networking sites such as Facebook, LinkedIn, YouTube, and Twitter are becoming increasingly useful in business, and the real estate industry is no different. Recognizing the value and pervasiveness of these sites, sponsoring **brokers should set out clear guidelines in policy manuals and brokerage agreements to permit and guide the use of these technologies by licensees**.



Sponsoring brokers must also learn about the potential risks and liabilities of these sites, for instance, **recognizing that communication through these sites establishes a permanent record of sorts and should incorporate this understanding into the policies and guidelines they establish for licensees on the use of social networking in their businesses.**

## ANTITRUST

Violations include:

- Price-fixing,
- Group boycotting,
- Allocation of customers,
- Allocation of markets, and
- Tie-in agreements (tying).

### Price-Fixing

**Price-fixing** is the practice of setting prices for products or services rather than letting competition in the open market establish those prices. In real estate, **price-fixing occurs when competing real estate companies agree to set standard sales commissions, fees, or management rates or if they attempt illegal tying arrangements.**

**Price-fixing is illegal.** Real estate companies must **independently determine any minimum commission rates or minimum fees**. These decisions must be based on a company's business judgment and revenue requirements without input from other real estate companies.

**MLSs, Boards of REALTORS®, and other professional organizations may not set fees or commission splits.** They cannot deny membership to licensees based on the fees the licensees charge.

The challenge for real estate licensees is to avoid even the impression of price-fixing. Hinting to prospective clients that there is a "going rate" of commission or a "normal" fee also implies that rates are, in fact, standardized, which must be avoided. The licensee must make it clear to clients that any stated minimum is **only the firm's minimum**. The specific commission is negotiable in a fair market.

### Group Boycotting

Group boycotting occurs when two or more businesses conspire against another business or agree to **withhold their patronage to reduce competition**. Group boycotting is illegal under antitrust laws.

### Allocation of Customers or Markets

Allocation of customers or markets involves an agreement among real estate companies **to divide their markets and refrain from competing for each other's business**. Allocations may be made on a geographic basis, with real estate companies agreeing to specific territories within which they will operate exclusively. The division also may occur by markets, such as by price range or category of housing. These agreements result in reduced competition.

### Tie-in Agreements

Tie-in agreements, also known as *tying agreements*, are **agreements to sell one product only if the buyer purchases another product as well**. The sale of the first (desired) product is "tied" to the purchase of a second, less desirable product.

### Penalties

The penalties for violating antitrust laws are severe. For instance, under the *Sherman Antitrust Act*, people who fix prices or allocate markets may be subject to a maximum \$1 million fine and up to ten years in prison. For corporations, the penalty may be as high as \$100 million.

## OTHER CONSUMER PROTECTION MEASURES

### National Do Not Call Registry

In 2003, the **Federal Communications Commission (FCC)** established the **National Do Not Call Registry**. The registry is a list of phone numbers of consumers who do not want to be contacted by commercial telemarketers. It is managed by the FTC and is enforced by the FTC, the FCC, and state officials. The registry applies to any plan, program, or campaign to sell goods or services through interstate phone calls.

The registry does not limit calls by:

- Political organizations,
- Charities,
- Collection agencies
- Telephone surveyors.

**Fortunately, the law establishes specific guidelines for when licensees may contact consumers, even when they are listed in the National Do Not Call Registry.**

**Licensees are permitted to call consumers with whom they have an established business relationship up to 18 months following the consumer's last payment, purchase, or delivery.** With consumers on the registry who have **submitted applications or made inquiries**, licensees are allowed additional contact for up to three months after the fact.

### Accessing the National Do Not Call Registry

Sellers, telemarketers, and other service providers **must register to access the registry**. The do-not-call registry may not be used for any purpose other than preventing telemarketing calls to the telephone numbers on the registry. Regulators say that **brokerage companies must have a do-not-call policy even if they do not engage in cold calling**. A company that is a seller or telemarketer could be in violation of the law for placing any telemarketing calls (even to numbers not on the do-not-call registry) if the company does not have a **policy for access to the registry**. Violators may be subject to fines for each call placed.

To successfully avoid penalties ("safe harbor"), the seller or telemarketer must demonstrate the following:

- It has written procedures to comply with the do-not-call requirements.

- It trains its personnel in those procedures.
- It monitors and enforces compliance with these procedures.
- It maintains a company-specific list of telephone numbers it may not call.
- It accesses the national registry every 31 days before calling any consumer and maintains records documenting this process.
- It must show that any call made in violation of the do-not-call rules was the result of an error.

The best source of information about complying with the do-not-call rules is the FTC's Websites: [www.donotcall.gov](http://www.donotcall.gov) and [www.ftc.gov](http://www.ftc.gov). They include business information about the registry.

**The CAN-SPAM Act of 2003** (Controlling the Assault of Non-Solicited Pornography and Marketing Act) establishes requirements:

- for sending commercial e-mail,
- spells out penalties for those that don't comply, not just "spammers",
- gives consumers the right to have e-mailers stop e-mailing them.

The act **does not apply to "transactional or relationship content,"** that is, those messages meant to facilitate or alter existing customer agreements (for instance, by giving a customer additional information about an existing agreement or conducting business as part of an existing agreement); however, these e-mails must not explicitly or implicitly operate for the purposes of advertising or promotion, as this would be in violation of the law.

Briefly, the CAN-SPAM Act requires the following:

- *False or misleading header information is banned.* An e-mail's "From," "To," and routing information- including the original domain name and e-mail address must be accurate and identify the person who initiated the e-mail.
- *Deceptive subject lines are prohibited.* The subject line cannot mislead the recipient about the contents or subject matter of the message.
- E-mail *recipients* must have an opt-out method. You must provide a return e-mail address or another Internet-based response mechanism that allows a recipient to ask you not to send future e-mail messages to that e-mail address and requests must be honored.

Each violation is subject to fines. Deceptive commercial e-mails are also subject to laws banning false or misleading advertising. Additional fines are provided for commercial e-mailers who violate the rules and do any of the following:

- "Harvest" e-mail addresses from Websites or Web services that have published a notice prohibiting the transfer of e-mail addresses for the purpose of sending e-mail
- Generate e-mail addresses using a "dictionary attack" combining names, letters, or numbers into multiple permutations
- Use scripts or other automated ways to register for multiple e-mail or user accounts to send commercial e-mail
- Relay e-mails through a computer or network without permission for example, taking advantage of open relays or open proxies without notification.

**Licensees in Illinois should be aware that they are subject to additional regulation in their use of commercial e-mail, per the Illinois Electronic Mail Act. The use of e-mail communication and Web advertising is also restricted as laid out in "Rules" Section 1450.145.**

### **The Junk Fax Prevention Act**

The Junk Fax Prevention Act of 2005 does **not legalize unsolicited fax advertisements** or solicitations but does **allow for an established business relationship exception**. As a general rule, a real estate licensee could not legally send an unsolicited commercial fax message without express written consent or without an established business relationship with the recipient.

Following are the provisions of the fax law:

- Sets out guidelines for what constitutes an established business relationship (EBR) and reaffirms that EBR when customers pose exceptions to the ban on unsolicited commercial faxes
- Does not place time limitations on EBRs
- Requires companies to offer a free method by which fax recipients may opt-out of receiving future fax communications. The opt-out method must be available at any time of day, every day, and the opt-out information must be made available on the first page of the fax.
- Requires businesses to receive customer's written or oral consent to send fax advertising, or in the case of new business relationships, to send only to those customers who have provided their fax numbers willingly to some other source with permission for such use by other parties (including the sender)
- Permits businesses to send faxes to numbers that they had access to via an EBR prior to July 9, 2005, when the act became law.
- Requires businesses to receive direct consent from EBR customers for whom they did not already have fax numbers prior to the effective date of the legislation, or to obtain these numbers via some other source to which the EBR customer willingly provided them with permission for such use by other parties (including the sender).

### **STATE LICENSE LAWS**

All 50 states, the District of Columbia, and all Canadian provinces **license and regulate the activities of real estate professionals. While the laws share a common purpose, the details vary from state to state.**

**Real estate license laws have been enacted to protect the public** by ensuring a standard of competence and professionalism in the real estate industry. The laws achieve this goal by:

- **establishing** basic requirements for obtaining a real estate license and, in many cases, requiring continuing education to keep a license,
- **defining** which activities require licensing,
- **describing** the acceptable standards of conduct and practice for licensees, and
- **enforcing** those standards through a disciplinary system.

The purpose of these laws is not merely to regulate the real estate industry. Their main objective is to **make sure that the rights of purchasers, sellers, tenants, and owners are protected from**

**unscrupulous or sloppy practices.** However, by establishing minimum levels of competency and limits of permitted behavior, laws can make the marketplace safer and more honest.

## BROKERAGE AGREEMENTS

**Brokerage agreements are employment contracts for the personal professional services of the sponsoring broker, not for the transfer of real estate.** The various types of brokerage agreements establish the basic relationship between the parties and provide different levels of rights and responsibilities for the sponsoring broker. Perhaps most important, brokerage agreements address the essential questions of exclusivity and compensation.

A **listing agreement** is an employment contract between a sponsoring broker and a seller; a buyer representation agreement is an employment contract as well because it establishes the rights and responsibilities of the sponsoring broker as agent for the buyer.

A **management contract** sets up the relationship between the sponsoring broker and the owner of a rental property.

In Illinois, per **Section 1450.195**, a brokerage agreement is either a written or oral agreement between a sponsoring broker and a client for licensed real estate activities to be provided to a client in return for compensation or the right to receive compensation from another. **Brokerage agreements may constitute either a bilateral or a unilateral agreement between the sponsoring broker and the sponsoring broker's client depending upon the content of the brokerage agreement. All exclusive brokerage agreements must be in writing.**

Also in Illinois, each broker agreement must clearly state that it is illegal for either the owner or the sponsoring broker to refuse to display or sell to any person because of one's membership in a protected class (e.g., race, color, religion, national origin, sex, ancestry, age, marital status, physical or mental handicap, familial status, or any other class protected by **Article 3 of the Illinois Human Rights Act**). **Employment** contracts with buyers and sellers create special agency relationships between the principal/client (the person who is being represented by the sponsoring broker) and the sponsoring broker (the agent). As agent, the sponsoring broker is authorized to represent the principal/client to third parties.

Under both the law of agency and most state license laws, only a sponsoring broker can act as the legal agent to list, sell, rent, or purchase another person's real estate and provide other services to a principal. All sponsored licensees of a sponsoring broker may perform these acts in the name of and under the supervision of the sponsoring broker only (Designated Buyer or Seller Agent).

## Expiration of Brokerage Agreement

All exclusive brokerage agreements should specify a definite period during which the broker is to be employed. In Illinois, as in most states, failing to specify a definite termination date in a listing agreement is grounds for the suspension or revocation of a real estate license.

### Automatic Extension

Pursuant to Section 10-25 of the Illinois Real Estate License Act of 2000, **no licensee shall obtain any written brokerage agreement containing a clause automatically extending the period of the contract.**

### TYPES OF LISTING AGREEMENTS

Four basic types of buyer agency agreements exist:

1. Exclusive-right-to-sell listing agreements
2. Exclusive-agency listing agreements
3. Open Listing Agreement
4. Net Listing

#### Exclusive-right-to-sell listing agreements

In an exclusive-right-to-sell listing, **one broker is appointed as the seller's sole agent.** The listing broker is given the exclusive right or authorization to market the seller's property. **If the property is sold while the listing is in effect, the seller must pay the broker a commission regardless of who sells the property:** the listing broker, another broker, or even if the seller finds a buyer without the broker's assistance. Sellers benefit from this form of agreement because the broker feels freer to spend time and money actively marketing the property, making a timely and profitable sale more likely. From the broker's perspective, an exclusive-right-to-sell listing offers the greatest opportunity to receive a commission. **The majority of residential listing agreements in Illinois are exclusive-right-to-sell listing agreements.**

#### Exclusive-agency listing agreements

In an exclusive-agency listing, **one broker is authorized to act as the exclusive agent of the seller-principal.** However, the **seller retains the right to sell the property without obligation to the broker.** The seller retains the right to sell the property without financial obligation to the listing broker.

#### Open listing agreement

In an open listing (known in some areas as a *nonexclusive listing*), the **seller retains the right to employ any number of brokers as agents.** The brokers can act simultaneously, and the seller is financially obligated only to that broker who successfully produces a ready, willing, and able buyer. If the seller personally sells the property without the aid of any of the brokers, the seller is not obligated to pay a commission.

**Negotiated terms of an open listing agreement should be in writing to protect the broker's ability to collect an agreed-on fee from the seller.** Written terms may be in the form of a listing agreement (if the broker represents the seller) or a fee agreement (if the broker represents the buyer or the seller does not wish to be represented). However, many Open Listing Agreements are oral.

#### Net listing

A net listing provision specifies that the **seller will receive a net amount of money from any sale, with the excess going to the listing broker as commission.** The broker is free to offer the property at any price greater than the net amount the seller wants; the difference is the broker's fee. Because a

**net listing can create a clear conflict of interest between the broker's fiduciary responsibility to the seller and the broker's profit motive, net listings are legal in Illinois but not recommended due to the potential for fraud.**

### **Case Studies/Scenarios/Role-playing #3**

**Part A.** Broker Frankie is a very successful top real estate agent in his market area for over 20 years. A very close friend of broker Frankie decided to list his home. The seller, Michael, is a very successful businessperson with many business connections in the same area. Broker Frankie provided a very detailed Market Analysis on Michael's property, and according to the Market Analysis, the current market value is \$500,000. Seller Michael felt that since broker Frankie is a top producing agent, seller Michael wanted to get as much as he can and wanted to list the property at \$550,000. Broker Frankie knows that he can sell the property if it is priced correctly at \$500,000. Broker Frankie wants the listing so that he can tap into Michael's business connections.

What should broker Frankie do?

- A. Broker Frankie should turn down the listing because it is overpriced at \$550,000.
- B. Broker Frankie should take the listing at \$550,000 and work a lot harder and try to sell the property.
- C. Broker Frankie should refer his client Michael to another agent so that his relationship with Michael will not be affected.
- D. Broker Frankie should review the market data with Michael and, if needed, reduce his commission so that seller Michael will get what he wants.

**Part B.** While reviewing the property disclosures, broker Frankie notice that seller Michael fail to disclose an existing seepage problem in the basement of the house.

What should Broker Frankie do?

- A. Broker Frankie should insist that the seepage problem be disclosed.
- B. Broker Frankie will inform the buyer only if asked.
- C. Wait for the inspection report and see if this issue is discovered.
- D. Broker Frankie should order an inspection by a professional to verify if there is a problem.

### **Guaranteed Sale**

Sometimes, **brokers and sellers enter into *guaranteed sale agreements*, in which the broker agrees to buy the listed property if it fails to sell before the end of the listing period.** Typically, these guarantees are made to the seller as an **inducement to list the property with the broker.**

**In Illinois, any exclusive listing agreement must be in writing and is subject to other legal requirements, noted in detail in the Illinois Real Estate License Act of 2000.**

## **SPECIAL LISTING PROVISIONS**

### **Multiple listing**

A *multiple listing* clause may be included in an exclusive listing. It is used by licensees who are members of a multiple listing service (MLS). **An MLS is an information/ marketing organization**

**whose members make their listings available for showing and sale through all the other member licensees.**

An MLS offers advantages to licensees, sellers, and buyers. Licensees develop a sizable inventory of properties to be sold and are assured a portion of the commission if they list property or participate in the sale of another licensee's listing. Sellers gain because the property is exposed to a much larger market. Buyers gain because of the variety of properties on the market.

The contractual obligations among the member licensees of an MLS vary widely. Most MLSs require that a licensee, **turn over new listings to the service within a specific, fairly short period of time after the licensee obtains the listing.** The length of time during which the listing licensee can offer a property to the public on her own without involving the MLS varies. Of course, sellers must be informed and give their written consent for any delay in notifying the MLS. This gives the listing company a strong chance to sell its own listing.

Under the provisions of most MLSs, a participating licensee makes a **unilateral offer of cooperation and compensation to other member licensees, when the listing enters the MLS.** The licensee must have the **written consent of the seller to include the property in an MLS.**

**Under Illinois law, a licensee working with a buyer is not considered to be a subagent of the seller. No offer of subagency can be made through an MLS in Illinois today. Illinois law states that a buyer is represented as a client by the licensee with whom she is working unless that consumer chooses not to be. This approach makes it clear to all parties who is represented by whom.**

While a few buyers choose to remain as customers without representation, **even that lack of agency is now subject to disclosure.** Generally, a **notice of no agency would be provided.** If nothing is said about agency, licensees are considered to be representing the consumer with whom they are working, either as a **designated agent for the consumer** (unless there is a written agreement to the contrary) or as a **licensee if performing only ministerial acts.**

**In spite of these relatively clear lines with regard to whose agent is whose, sellers often still pay the fees for both agents in a transaction.** These fees are called **cooperative commissions.** In an Illinois MLS listing datasheet, this is typically stated as "coop: X% or as a flat fee." ***Paying someone a commission does not create agency in Illinois.***

## TERMINATION OF LISTING AGREEMENTS

Because the licensee's services are unique, a brokerage agreement **cannot be assigned to another licensee without the principal's written consent.** The property owner cannot force the licensee to perform, but the **licensee's failure to work diligently toward fulfilling the contract's terms constitutes a breach of the listing agreement.** If the licensee cancels the listing, the seller may be entitled to sue the licensee for damages.



On the other hand, a **property owner could be liable for damages to the licensee by refusing to cooperate with the licensee's reasonable requests**, such as allowing the licensee to show the property to prospective buyers or refusing to proceed with a complete sales contract.

Listing agreements may be terminated for the following reasons:

- When the agreement's purpose is fulfilled, such as when a ready, willing, and able buyer has been found
- When the agreement's term expires
- If the property is destroyed or its use is changed by some force outside the owner's control, such as a zoning change or condemnation by eminent domain
- If title to the property is transferred by operation of law, as in the case of the owner's bankruptcy or foreclosure
- If the sponsoring broker and the seller mutually agree to cancel the brokerage agreement
- If either the sponsoring broker or seller dies or becomes incapacitated. **If the sponsored licensee dies or becomes incapacitated, the brokerage agreement is still valid.**

## SAFETY CLAUSE

**This is a clause in the listing agreement which provides the listing broker a commission if, within a specified time period after the listing agreement expires, the owner transfers property title to someone who saw the property while it was listed with the broker.** The Safety clause protects brokers from losing a commission on a sale involving buyers who saw the property while it was listed and to **discourage others from trying to reach private arrangements with sellers.**

### Safety Clause Features:

- The length of time for a Safety cause is set by agreement.
- Any new buyers the seller might procure on her own after expiration of the listing are not affected.
- This clause cannot be enforced if the property is relisted under a new contract with another brokerage firm.

Each brokerage agreement for a residential property of four units or less that provides for a protection period subsequent to its termination date shall also provide that no commission or fee will be due and owing pursuant to the terms of the brokerage agreement if, during the protection period, a valid, written brokerage agreement is entered into with another licensed real estate broker.

## THE LISTING PROCESS

### Measuring Structure and room count

It is important to understand when it comes to measuring a property, there is no one size fits all method employed by appraisers, real estate agents, lender, or government units. To varying degrees, guidelines define Gross Living Area (GLA).

Fannie Mae, HUD/FHA guidelines do not include basements/below grade, unfinished areas, and garages in the Gross Living Area. Appraisers measure the exterior of each floor to the inch.

Fannie Mae/Freddie Mac form appraisal report, used by conventional lenders as well as FHA/VA, describes the house by the total room count, the number of bedrooms, and the number of bathrooms it contains.

In general, a room count is a kitchen, bedroom, a living room, a dining room, a family room, an office, study, or den. There are always restrictions as to what guidelines are used. Real estate agents need to measure structures and room counts correctly in order to raise the standard of professionalism and improve the consumer confidence.

### **Qualifying the Seller**

When meeting the potential client for the first time, the agent shall spend time gathering information on the seller's needs and motivation. The seller should understand the process involved in selling, marketing, and setting a range for listing their property. The agent should gather data on the community so that the agent can target any potential buyers.

Asking questions about the property amenities allows the agent to point out the benefits of the property. When asking the seller questions, wait and listen to the seller's answer to avoid any misunderstanding. Remember, buying and selling a house is probably the biggest investment in someone's life. Providing what is expected in the sale of real estate allows the seller to have a positive experience and a successful transaction.

### **Pricing the Property**

While it is the responsibility of the broker to advise and assist, it is the seller who must determine the listing price for the property. Because the average seller does not have the skills needed to determine a market-based listing price, brokers must be prepared to offer their knowledge and expertise.

Brokers can help sellers determine a listing price for the property by using a **comparative market analysis (CMA)**. A CMA analyzes properties similar to the subject property in size, location, and amenities. It is distinctly different from an appraisal report offered by a licensed appraiser that is based only on an analysis of properties that have actually sold.

The CMA is based on:

- Recently closed properties (solds),
- Properties currently on the market (competition for the subject property), and
- Properties that did not sell (expired listings in the area).

Sold prices represent what buyers have been willing to pay for similar properties in the neighborhood. Very often, the expired listing prices are those prices that buyers have not been willing to pay for a property similar to the subject property.

### **Market Value**

**Market value is the most probable price a property would bring in an arms-length transaction under normal conditions on the open market.**

Current asking prices of current, similar properties on the market indicate the trend: asking prices lower than the "solds" indicate a slow or declining market. An optimistic market is indicated when the asking prices are higher than the "solds." Although a CMA is not viewed as a formal appraisal, the **broker uses many of the appraiser's methods and techniques in arriving at a reasonable value range.**

The figure sought in both CMAs and appraisals is the **property's market value. Market value is the most probable price a property would bring in an arms-length transaction under normal conditions on the open market.** A CMA estimates market value as likely to fall within a range of values (e.g., \$335,000 to \$340,000).

While it is the **property owner's privilege to set whatever listing price he chooses, a broker should consider rejecting any listing in which the price is substantially exaggerated or severely out of line with the indications of the CMA or appraisal.** These tools provide the best indications of what a buyer will likely pay for the property. An unrealistic listing price will make it difficult for the broker to properly market the seller's property within the agreed-upon listing period. Furthermore, a buyer may have difficulty obtaining financing because the property did not appraise for the sale price.

### Information Needed for Listing Agreements

Once the broker and the owner agree on a listing price, the broker must **obtain specific, detailed information about the property.** Obtaining as many facts as possible ensures that most contingencies can be anticipated. This is particularly important when the listing will be shared with other licensees through an MLS, and the other licensees must rely on the information taken by the listing broker.

### THE LISTING AGREEMENT

**In Illinois, the listing contracts most commonly in use are prepared by local REALTOR® associations and their attorneys. These forms may vary slightly from area to area.**

**Illinois law requires that the following disclosures be included with listing contracts.**

- **Disclosure of material facts** - A broker must not withhold material facts concerning a property of which she has knowledge from any purchaser, prospective purchaser, seller, lessee, lessor, or other party to the transaction. **Material facts are any facts on which a reasonable person would base a contractual decision.**
- **Disclosure of interest** - A broker must disclose in writing to the parties to the transaction her status as a broker and any **direct or indirect interest (s)he has or may have in the subject property.** For example, if the buyer or seller is a licensed broker, this must be clearly stated in the contract.
- **Disclosure of special compensation** - A broker is **prohibited** from accepting "**any finder fees, commissions, discounts, kickbacks, or other compensation from any financial institution, title insurance company, or any other person other than another licensee, without full disclosure in writing of such receipt to all parties to the transaction.**" Sponsored licensees receive any such compensation only through their respective sponsoring brokers.
- **Earnest money and purchaser default** - When any written listing includes a provision that the seller will not receive the earnest money deposit if the purchaser defaults, this fact must appear **emphasized in letters larger than those otherwise used in the listing agreement.**

- **Disclosure of property condition - Seller disclosure of property conditions is required by law in Illinois.** These disclosures normally cover a wide range of structural, mechanical, and other conditions that a prospective purchaser should know about to make an informed decision.
- **A Property Disclosure Report** must be given to the buyer before an offer is made and accepted or the buyer will have **three days** in which to rescind the contract, based on any negative disclosures. In addition, a **lead paint disclosure** is required on any property built before 1978, and a **radon disclosure** is **required** of the seller.

Once a long-lasting agreement has been finalized and signed by the broker and seller, Illinois law prohibits the broker from making any addition to, deletion from, or alteration of the written listing without the written consent of the principal. **The broker must return a true copy of the listing agreement, signed by the seller and by the sponsoring broker or designated managing broker, to the principal within 24 hours of execution.**

### **Listing Agreement Content**

**There is no required state form for any real estate contract in Illinois. However, all written exclusive listing agreements must include:**

- the list price of the property,
- the agreed-upon amount of commission and the time of payment,
- the duration of the agreement, with a definite termination date clearly set forth,
- the names of the broker and seller,
- signatures of both broker and seller,
- the identification of the property involved (address or legal description),
- the duties of the listing broker,
- a statement of nondiscrimination, and
- a statement regarding antitrust.

Licensees **may not permit blank spaces on their signed brokerage agreements**. Where no information is to be inserted into the blank space, the Licensee should insert NA or draw a line through the blank space.

### **Type of listing agreement**

The contract may be an exclusive-right-to-sell listing (the most common type), an exclusive-agency listing, an open listing, or a net listing (the last not recommended). The type of listing agreement determines the extent of a broker's authority to act on the principal's behalf. Most MLSs do not permit open listings to be posted in their systems.

### **BROKER'S AUTHORITY AND RESPONSIBILITIES**

The contract should **specify whether the broker may place a sign on the property and advertise and market the property or utilize social networking through Facebook or other similar sites.**

**Another new major consideration, since the inception of Buyer Broker Representation in Illinois, is whether the broker is permitted to authorize buyers' broker's marketing efforts**

**through an MLS and the Internet.** It should also address whether or not the broker may accept earnest money on behalf of the seller and the responsibilities for holding the funds.

### **Names of all parties to the contract**

**Anyone who has an ownership interest in the property must be identified and must sign the listing to validate it.** If the property is owned under some form of co-ownership, that fact should be clearly established.

**If a married couple is living in the listed property, both spouses must sign the listing, even if only one owns the property, in order to release homestead rights. If the property is in the possession of a tenant, that should be disclosed and instructions given on how the property is to be shown to a prospective buyer.**

### **Brokerage firm**

The brokerage company name, the sponsoring broker, and the *designated agent* of the sponsoring broker must all be identified.

### **Evidence of ownership**

A warranty deed, title insurance policy, or abstract of title with an attorney's opinion can be used for proof of title.

### **Listing price**

**This is the proposed gross sales price.** The seller's proceeds will be reduced by unpaid real estate taxes, special assessments, mortgage or trust deed debts, and any other outstanding obligations.

### **Real property and personal property**

**Any real property to be removed from the premises by the seller and any personal property to be included in the sale for the buyer should be noted and be explicitly identified in the subsequent purchase contract.** Some items that may later become points of negotiation might include major appliances, swimming pool and spa equipment, fireplace accessories, storage sheds, window treatments, stacked firewood, and stored heating oil.

### **Leased equipment**

It must be determined if leased equipment such as security systems, cable television boxes, water softeners, or special antennas will be left with the property. If so, the seller is responsible for notifying the equipment's lessor of the change of property ownership.

### **Description of the premises**

**In addition to the street address, the legal description, lot size, and tax parcel number (property index number or PIN) may be required for future insertion into a purchase offer.**

**The street address of the property (street address and unit number for a condo) is sufficient for listing agreements to be valid and enforceable under Illinois law.** However, it is advisable to include

the parcel number (or property index number, or PIN), and most listing agreements include a blank for it. This number can be acquired from the tax database.

### **Proposed dates for the closing and the buyer's possession**

**These dates should be based on an anticipated closing date.** The listing agreement should allow adequate time for the paperwork involved (including the buyer's qualification for any financing) and the physical moves to be arranged by the seller and the buyer.

### **The closing**

An attorney, title company, or escrow company should be considered and retained as soon as possible. A designated party will be needed to complete the settlement statements, disburse the funds, and file the proper forms, such as documents to be recorded and documents to be sent to the IRS.

### **Legal Rights and Obligations of the Seller and Buyer**

As each contract is prepared for signature during a real estate transaction, the licensee should advise the parties of the desirability of securing legal counsel to protect their interests. **Only a lawyer can offer legal advice. Licensees are prohibited from practicing law. In Illinois, the attorney, title company, and lender dominate closing issues.**

### **Encumbrances**

All liens must be paid by the seller or be assumed by the buyer at the closing. Identify as much information as possible about existing loans, such as the name and address of each lender, the type of loan, the loan number, the loan balance, the interest rate, the monthly payment, and if the loan can be prepaid without penalty. Determine if the buyer can assume the present loan, and if so, under what circumstances and if there is any possibility of seller financing.

**Physical encroachments on the property (such as a fence) and their legal implications are questions best referred to an attorney, even if they were noted in the listing file.**

### **Zoning**

Identify current zoning for the property.

### **Property taxes**

Ask about current (or most recent year's) property taxes and determine the amount of any outstanding special assessments and whether they will be paid by the seller or assumed by the buyer.

### **Home warranty program**

In some situations, it may be advisable to offer a "home warranty" with the property. Skillful brokers are able to explain these warranties that often benefit both the seller and the buyer.

### **Commission**

The circumstances **under which a commission will be paid must be specifically stated in the contract.** Negotiation of commission is a key discussion point in creating a listing contract. The commission amount is fully negotiable between parties.

**By Illinois law, written listing agreements in Illinois must state that no change in the amount of the commission or time of payment will be valid or binding unless the change is made in writing and signed by all parties.**

### **Antitrust wording**

**Any assertion that a "set" or "standard" commission exists violates antitrust laws.** Any sponsoring broker is free to set a minimum commission that will be accepted within a given office, but there is *no such thing as a standard commission*. The contract should indicate that all commissions have been negotiated between the seller and the broker. It is illegal for commissions to be set by any regulatory agency, trade association, or other industry organization.

### **Termination of the contract**

A contract should provide **some way for the parties to end it and under what circumstances** will the contract terminate.

**In Illinois, if a listing agreement provides that, in the event of a default by a buyer, the broker's full commission or fees will be paid out of an earnest money deposit, with the remainder of the earnest money to be paid to the seller, the provision shall appear in the listing agreement in letters larger than those generally used in the listing agreement.**

### **Broker protection ("carryover") clause**

Brokers are well-advised to protect their interests against possible fraud or a reluctant buyer's change of heart. There are various circumstances under which a broker is entitled to a commission for a specified amount of time after an agreement terminated.

### **Warranties by the owner**

**The owner is responsible for certain assurances and disclosures that are vital to the agent's ability to market the property successfully.**

### **Indemnification ("hold harmless") wording**

**The seller and the broker may agree to hold each other harmless (i.e., not to sue one another) for any incorrect information supplied by one to the other.** Indemnification may be offered regardless of whether the inaccuracies are intentional or unintentional.

**A client shall not be vicariously liable in Illinois, for the acts or omissions of a licensee in providing brokerage services for or on behalf of the client.**

### **Nondiscrimination (equal opportunity) wording**

The seller must understand that **the property will be shown and offered without regard to the race, color, creed, or religious preference, national origin, family status, sex, age, or disability of the prospective buyer.** Federal, state, and local fair housing laws protect a variety of different groups and individuals. For instance, on the state and local level, sexual orientation and source of finances are also often protected.

**All Illinois written listing agreements must clearly state that it is illegal for either the owner or the broker to refuse to sell or show property to any person because of race, color, religion, national origin, sex, familial status, ancestry, citizenship status, age 40 and over, marital status, physical or mental disability, military service, unfavorable military discharge, sexual orientation, and order of protected status.**

### **Minimum Services**

All exclusive brokerage agreements must specify that the sponsoring broker, through its sponsored licensees, must provide the following required minimum services:

- Accept delivery of and present to the client all offers and counteroffers to buy, sell, or lease the client's property or the property the client seeks to purchase or lease
- Assist the client in developing, communicating, negotiating, and presenting offers, counteroffers, and notices that relate to the offers and counteroffers until a lease or purchase agreement is signed and all contingencies are satisfied or waived
- Answer the client's questions relating to the offers, counteroffers, notices, and contingencies

**This applies to listing (seller) agreements as well as buyer agency agreements**

### **The signatures of the parties**

All parties identified in the listing contract must sign the contract, including all individuals who have a legal interest in the property.

### **The date the contract is signed**

This date may differ from the date the contract actually becomes effective (e.g., if a sponsored licensee takes the listing and then must have the sponsoring broker sign the contract to accept employment under its terms).

### **Additional information**

Although not required on the listing agreement, the listing broker should also obtain any additional information that would make the property more appealing and marketable, such as neighborhood amenities. Such amenities might include information about schools, parks and recreational areas, places of worship, and public transportation.

### **Case Studies/Scenarios/Role-playing #4**

Broker Kimberly has an exclusive right to sell listing agreement with her buyer on a house that is overpriced. The property has been on the market for more than six months with very little activity, despite broker Kimberly's efforts. Kimberly has hosted several open houses with little interest. A potential buyer, knowing that the property is overpriced, presents a low-ball offer through his agent. The buyer's agent told Kimberly that the seller should accept their offer as the property has been on the market for a long time and needs repairs.

What should Kimberly do?

- A. Broker Kimberly should present the offer to the seller and try to get a counteroffer.



- B. Broker Kimberly should tell the seller that if they don't take this offer, she will cancel the listing agreement.
- C. Broker Kimberly should refuse to present the offer and stop promoting a property she cannot sell.
- D. Broker Kimberly should get the seller to reduce the price so that it will sell

## BUYER AGENCY AGREEMENTS

Like a listing agreement, a buyer agency agreement is an employment contract. In this case, **the broker is employed as the buyer's agent. The buyer, rather than the seller, is the principal.** The purpose of the agreement is to find a suitable property. **A buyer agency agreement gives the buyer a degree of representation possible only in a fiduciary relationship.** A buyer's broker must protect the buyer's interests at all points in the transaction.

Three basic types of buyer agency agreements exist:

1. Exclusive-buyer-agency agreement (Like an exclusive-right-to-sell agreement for a Seller)
2. Exclusive-agency-buyer agreement (Like an exclusive agency agreement for a Seller)
3. Open buyer agency agreement (Like an open listing agreement with a Seller)

### Exclusive buyer agency agreement

Also known as *an exclusive right to represent*, this is a **true exclusive agency agreement. The buyer is legally bound to compensate the broker whenever the buyer purchases a property of the type described in the contract. The broker is entitled to payment regardless of whether she or the buyer locates the property and signs a sales contract.**

### Exclusive-agency buyer agency agreement

Like an exclusive buyer agency agreement, this is an **exclusive contract between the buyer and the broker. The buyer retains the right to locate and buy property without paying a commission to the broker.** Buyer brokers end up "educating" buyers about the process and show many homes only to find that the buyers avoid compensation by working directly with an unlisted property owner, (For Sale by Owner FSBO).

### Open buyer agency agreement

This agreement is a **nonexclusive buyer representation agreement between a broker and a buyer.** It permits the buyer to enter into similar agreements with an unlimited number of brokers. The buyer is obligated to compensate only the broker who locates the property the buyer ultimately purchases.

## Buyer Representation Issues

A broker and a buyer must discuss a number of issues after entering into a written buyer agency agreement. The broker should conduct a counseling session with the buyer to determine the **buyer's needs and goals, financial capabilities, and motivation.** This session gives the broker the ability to **educate the buyer on the buying process and market conditions and to formulate a strategy for finding the right property.** In addition, compensation needs to be addressed and negotiated in the event there is no offer of cooperative compensation from the listing broker to the buyer's broker.

The broker should make the same disclosures to the buyer that the broker would make in a listing agreement. The broker should **explain the forms of agency available and the parties' rights and responsibilities under each type of agreement**. The specific services provided to a buyer-client need to be clearly explained.

**A buyer's broker may be compensated by either the buyer or the seller. Compensation is always negotiable.**

In Illinois, it is common for the listing broker to split the listing fee with the buyer's broker. Note that this is a **clear case where commission does not equate to agency or representation**. Discussions regarding a commission or fee provided by the buyer may still take place. A broker is free to negotiate for compensation from any buyer for whom service was provided in an agency capacity. However, if the broker receives compensation from more than one source in a transaction, it always needs to be disclosed in writing to the involved parties.

**A buyer agent's duties include:**

- using the broker's best efforts to identify properties listed in the MLS and in other databases that meet buyer's criteria,
- arrange for property inspections identified by buyer as potentially appropriate for purchase,
- advise buyer as to the pricing of comparable properties,
- assist buyer in the negotiation of a sales contract acceptable to buyer, and
- to provide confidentiality on any information that buyer discloses to the broker.

**Services Provided by a Buyer Broker**

The buyer's broker provides the following services throughout the real estate transaction:

- **Needs assessment-** Determine and evaluate the needs and wants of the buyer.
- **Property selection** - Locate the best property for the buyer by notifying buyers of new listings and for-sale-by-owner properties. Remember, property selection need not be limited by price. In today's market, list prices can often be negotiated down.
- **Viewing properties** - Provide an objective evaluation of the property and show buyers how to compare properties. Disclose material facts that are pertinent to the property.
- **Negotiate** - Strategize with the buyer, suggesting techniques that strengthen the buyer's position. Then, implement those strategies on the buyer's behalf. Disclose any prior unsuccessful negotiations.
- **Price** - Provide price counseling and prepare a comparative market analysis (CMA) on the property the buyer is considering.
- **Follow-up** - Resolve any issues that could prevent a closing from occurring. Provide ongoing communications with the client, preferably by e-mail for maintaining records.
- **Short Sale** – Explain the operation of a short sale, the time frame for a decision from the Seller's lender, and other aspects of a Short Sale. Ask the Buyer's Lender for a possible extension of the Commitment Letter if a Short Sale takes longer than anticipated.

**Case Studies/Scenarios/Role-playing #5**

Agent Michelle is hosting an Open House on one of her listings. A potential buyer Sue attends the open house and doesn't have a real estate agent with her. Buyer Sue says, "I want to buy this house." The

listing agent Michelle makes sure that the buyer Sue understands that broker Michelle represents the seller and not required to look out for the best interest and has Sue sign a Non-Agency Disclosure form. Buyer Sue signs the Non-Agency Disclosure form and the purchase agreement to buy the property. There is no inspection by the buyer, and the property closes. Soon after the closing, a structure problem came to Sue's attention. The seller was not aware of any structure issue.

- A. Buyer Sue has a right to go after broker Michelle to correct this problem
- B. Sue has a right to go after the seller of the property.
- C. Sue can seek compensation from the seller and broker Michelle
- D. Broker Michelle and the seller have no liability to Sue for any repairs.

### **Buyers Representation/Agency Disclosures**

Broker Vic was working with a buyer Sue and had the buyer sign an Exclusive Buyer Agency Agreement. After working with the buyer for a few months, showing the buyer many properties making sure the buyer was qualified by a lender, broker Vic went out of town for 3 days. While broker Vic was out of town, the buyer Sue visited an Open House. Buyer Sue told the listing agent that she didn't have an agent representing her. The listing broker had Sue sign a non-agency disclosure form and purchased the property. When broker Vic returns from out of town, broker Vic told the listing agent Michelle that he has an exclusive buyer agency agreement and has been working with buyer Sue for many months.

What should Broker Vic do?

- A. Broker Vic should discuss any compensation with the buyer Sue.
- B. Broker Vic is entitled to a co-op commission from broker Michelle.
- C. Broker Michelle has no obligation to offer any compensation from broker Michelle.
- D. Broker Vic should refer to the Buyer Representation agreement and file a lawsuit against broker Michelle.

### **THE BUYING PROCESS**

When the buyers have found the right property, the next step is to prepare and negotiate an offer that will lead to a signed sales contract between the seller and the buyer. The buyer's broker must prepare a CMA to establish a price for the buyer to offer. Factors to take into consideration include:

- **Property condition** - Does the property need a lot of repairs?
- **Length of time on the market** - This indicates the selling pace of the market, the level of inventory, or a potential problem with the property.
- **Supply and demand** - Essentially, when supply increases and demand remains stable, prices go down; when demand increases and supply remains stable, prices go up.
- **Seller's motivation** - Is the property in distress, pre-foreclosure, or requiring a short sale?
- **Terms and contingencies** - The fewer the contingencies, the stronger the offer, making it more attractive to the seller or bank (if property is bank-owned or requires bank approval for a short sale).

**When buyer brokers are working with two or more clients who are seeking similar properties in the same price range, the buyer's broker is permitted to show alternative properties to any prospective buyer or tenant.**

Specifically, the buyer's broker does not breach a duty or obligation to the client:

- by showing alternative properties to other prospective buyers or tenants,
- by showing properties in which the client is interested to other prospective buyers or tenants,
- by making or preparing contemporaneous offers or contracts to purchase or lease the same property.

**However, brokers must provide written disclosure to all clients for whom the licensee is preparing or making contemporaneous offers or contracts to purchase or lease the same property** and shall refer to another designated agent any client that requests such referral.

### **Presenting and Negotiating the Offer**

Once an offer has been made and the buyer has signed the purchase agreement and disclosures, the buyer should immediately receive a copy of all of the documents that are signed. The real estate agent of the buyer should then promptly submit the signed purchase agreement along with the signed disclosures, pre-approval letter from the lender or proof of funds and a copy of the earnest money check if any. This can be done in person or electronically to the agent of the seller. The agent of the buyer should be available if there are any questions regarding the offer.

### **Disclosure of Contemporaneous Offers**

"Contemporaneous Offers" shall be offers to purchase or lease on behalf of two or more clients represented by the same designated agent for the same real estate parcel or rental unit that the designated agent knows or has reason to know will be taken under consideration by the owners or owners' representative at the same time. If there are contemporaneous offers from two or more clients of a designated agent, written disclosure shall be provided to the clients of the designated agent and referrals of clients to other designated agents shall be completed, if requested by the client.

The agent that is involved in a contemporaneous offer cannot disclose any information about the offers to any of the other clients. Oftentimes, the seller will counter the offer, typically asking for a higher purchase price or adjust the closing dates. The listing agent must promptly submit any counteroffer back to the buyer's agent.

### **Letter of Intent for Commercial Purchase**

A letter of intent is a document outlining the intention of two or more parties to do business together. It is often non-binding unless the language in the document specifies that the companies are legally bound to the terms.

A letter of intent is likely to encompass a number of different aspects and it varies in length according to the level of specificity and the type of transaction. All letters of intent lay out the basis of a deal, including cost, time frame, and contingencies.

When negotiating a sale on commercial property, the initial stage of creating an offer is the preparation of the letter of intent. The letter of intent is generally not considered to be a contract and therefore not binding upon the parties. Buyers usually prepare the letter of intent to purchase commercial property. Lessees often prepare a letter of intent to lease commercial space.

The party that signs the Letter of Intent (LOI) may be legally bound to honor it unless it is stated that the letter is non-binding.

## TERMINATION OF BROKER EMPLOYMENT AGREEMENTS

**A broker employment agreement is a contract between a broker and a seller or buyer.** Its success depends on the broker's personal and professional efforts.

**Because broker services are unique, a broker cannot turn over the contract to another broker without the principal's written consent.** The client cannot force the broker to perform, but the broker's **failure to work diligently toward fulfilling the contract's terms constitutes abandonment** of the contract. In the event the contract is abandoned or revoked by the broker, the principal is entitled to sue the broker for damages.

**On the other hand, the principal might fail to fulfill the terms of the agreement.** For instance, a property owner who refuses to cooperate with the broker's reasonable requests, such as allowing the broker to show the property to prospective buyers or refusing to proceed with a completed sales contract, could be liable for damages to the broker. If either party cancels the contract, one party may be liable for damages to the other.

### **An employment agreement may be canceled for the following reasons:**

- When the agreement's purpose is fulfilled
- When the agreement's term expires without a successful transfer
- If the property is destroyed or its use is changed by some force outside the client's control, such as a zoning change or condemnation by eminent domain
- If title to the property is transferred by operation of law, as in the case of the client's bankruptcy or Foreclosure sale:
- If the broker and client mutually agree to end the agreement
- If either the broker or the client dies or becomes incapacitated
- If either the broker or client breaches the contract, the agreement is terminated and the breaching or canceling party may be liable to the other for damages.

In Illinois, **except as may be provided in a written agreement between the broker and the client, neither a sponsoring broker nor any licensee affiliated with the sponsoring broker owes any further duties to the client after termination, expiration, or completion of performance of the brokerage agreement except:**

- to account for all monies and property relating to the transaction,
- to keep confidential all confidential information received during the course of the brokerage agreement.

## Multiple Offers

The listing agent must present **all offers** to purchase or lease as soon as possible. When representing a buyer, seller, landlord, tenant, or other client as an agent they must protect and promote the best interest of their client.

The presentation of multiple offers and negotiations are often complex. Remember the decision on when multiple offers are presented and how they will be negotiated and which offer if any will be accepted or countered is made by the seller - not the buyer agent or listing agent.

The listing agent when presenting multiple offers should always explain the pluses and minuses of all the terms and price. The decision is the seller's. It is important for the agent to present all offers objectively and explain the options and any alternatives available and get directions from the seller.

The National Association of Realtors has designed a brochure for consumers titled "A Buyers' and Sellers' guide to Multiple Offer Negotiations" that can be downloaded and should be reviewed with their agent.

## Case Studies/Scenarios/Role-playing #6 Handling Multiple Offers and Counteroffers

Seller Kelly listed her home with Broker Tiffany of Patton Realty Company. Broker Tiffany listed Kelly's property at a reasonable price, and the property attracted several offers, including an offer from broker Tiffany's own buyer. Broker Tiffany now has several offers, how should she proceed?

- A. Broker Tiffany should work with her own offer as a dual agent because she knows the buyer very well, and there will be no problem with this transaction if Tiffany controls both sides.
- B. Broker Tiffany should just go with the highest price offer.
- C. Broker Tiffany should give all of the offers to the seller and give the seller Kelly a few days to decide which one she wants to accept.
- D. Broker Tiffany should review, present, and discuss the terms of each offer and let the seller, Kelly, decide.

**NOTES:**

[illegible]

## CHAPTER 14: FAIR HOUSING

### EQUAL OPPORTUNITY IN HOUSING

The civil rights laws that affect the real estate industry ensure that everyone has the opportunity to live where they choose. **Federal, state, and local fair housing or equal opportunity laws affect every phase of a real estate transaction, from listing to closing.** However, while the passage of laws may establish a code for public conduct, **damaging attitudes reinforced by centuries of discrimination are not so easily eliminated.**

**Real estate licensees *must* eliminate actions or words that create discrimination (or the appearance of discrimination) if they wish to conduct an ethical and legal business.** Real Estate Licensees are held to a higher standard in terms of discrimination than an average citizen. At times, restraints on information a licensee can provide a client may hint at or support steering, so licensees cannot provide that information, by law. Similarly, any discriminatory attitudes of property owners or property seekers *must* be addressed by the licensee if these attitudes affect compliance with fair housing laws.

**The Illinois Real Estate License Act of 2000 and the general rules require that licensees fully adhere to the principles of equal housing opportunity.** A licensee is prohibited from taking any listing or participating in any transaction in which the property owner seeks to discriminate based on race, color, ancestry, religion, national origin, sex, handicap, or familial status.

**Breaking fair housing laws in Illinois is a criminal act and grounds for discipline.** Violating provisions or restrictions of the Illinois Real Estate License Act of 2000 (or the rules) **can result in suspension, nonrenewal, or revocation of the violator's license or censure, reprimand, or fine imposed by IDFPR.**

**The Real Estate License Act of 2000 requires that when a judgment in either a civil or criminal proceeding has been made against a licensee for illegally discriminating, his license must be suspended or revoked unless an appeal is active.** Finally, if there has already been an order by an administrative agency finding discrimination by a licensee, the **board must penalize the licensee.**

**In addition to state and federal laws, many cities and villages in Illinois have their own fair housing laws.** These laws are enforced on the local level and may take precedence over federal laws when the local law has been ruled substantially equivalent to the federal statute. Many local fair housing laws are stricter than state or federal laws. **The strictest law is the one that is enforced.** Licensees should be familiar with local regulations as well as with state and federal law.

### FEDERAL LAWS

The federal government's effort to guarantee equal housing opportunities to all U.S. citizens began with the passage of the **Civil Rights Act of 1866.** This law prohibits any type of discrimination based on race.



The U.S. Supreme Court's 1896 decision in *Plessy v. Ferguson* established the "separate but equal" doctrine of "legalized" racial segregation. A series of court decisions and federal laws in the 20 years between 1948 and 1968 attempted to address housing inequities resulting from *Plessy*. Those efforts, however, often addressed only specific aspects of the housing market (such as federally funded housing programs). As a result, their impact was limited. **Title VIII of the Civil Rights Act of 1968, however, prohibited specific discriminatory practices throughout the real estate industry.**

### ***Jones v. Mayer***

In 1968, the Supreme Court heard the case of *Jones v. Alfred H. Mayer Company*, 392 U.S. 409 (1968). In its decision, the court **upheld the Civil Rights Act of 1866**. This decision is important because although the federal law exempts individual homeowners and certain groups, the 1866 law **prohibits all racial discrimination without exception**. A person who is discriminated against on the basis of race may still recover damages under the 1866 law. **Where race is involved, no exceptions apply.**

The U.S. Supreme Court has expanded the definition of the term race to include ancestral and ethnic characteristics, including certain physical, cultural, or linguistic characteristics that are shared by a group with a common national origin. These rulings are significant because discrimination on the basis of race, as it is now defined, affords due process of complaints under the provisions of the Civil Rights Act of 1866.

### **Fair Housing Act**

**Title VIII of the Civil Rights Act** of 1968 prohibits discrimination in housing based on race, color, religion, and national origin. It also threw out the "Separate but Equal" provision.

In 1974, the **Housing and Community Development Act** added sex to the list of protected classes. In 1988, the **Fair Housing Amendments Act** added *disability* and *familial status* (that is, the presence of children). Today, these laws together are known as the federal **Fair Housing Act**.

The **Fair Housing Act** prohibits discrimination on the basis of race, color, religion, sex, disability, familial status, or national origin. The act also prohibits discrimination against individuals because of their association with persons in the protected classes.

The **Department of Housing and Urban Development (HUD)** administers the **Fair Housing Act**. HUD has established rules and regulations that further interpret impacted housing practices. In addition, **HUD distributes the equal housing opportunity poster**. This poster declares that the office in which it is displayed **promises to adhere to the Fair Housing Act and pledges support for affirmative marketing and advertising programs**. The fair housing poster should be displayed in every real estate office.

In 1988, Congress passed the **Fair Housing Amendments Act** that expanded federal civil rights protections. In addition to race, color, religion, and national origin being protected classes, the act extended coverage to include families with children and persons with physical or mental disabilities. The act also made the penalties more severe and added damages for noneconomic injuries (e.g., humiliation, embarrassment, inconvenience, and mental anguish).

In 1995, Congress passed the Housing for Older Persons Act (HOPA), which repealed the requirement that 55-and-older housing have "significant facilities and services" designed for seniors. HOPA still requires that at least 80 percent of occupied units have one person aged 55 or older living there. The act prohibits the awarding of monetary damages against those who, in good faith, reasonably believed that property designated as housing for older persons was exempt from familial status provisions of the Fair Housing Act.

### In Practice

When HUD investigates a licensee for discriminatory practices, it may consider failure to prominently display the equal housing opportunity poster in the licensee's place of business as evidence of discrimination.

### HUD Fair Housing Definitions

HUD's regulations provide specific definitions that clarify the scope of the Fair Housing Act.

#### Housing

The regulations define *housing* as a dwelling that includes any building or part of a building designed for occupancy as a residence by one or more families. A residential dwelling is defined as a 1-4 unit building where the owner lives in the building.

#### Familial status

Familial status refers to the presence of one or more individuals who have not reached the age of 18 and who live with either a parent or guardian. In effect, the familial status reference means that the act's protections extend to families with children. The term includes a woman who is pregnant.

Unless a property qualifies as housing for older persons, all properties must be made available to families with children under the same terms and conditions as to anyone else. It is illegal to advertise properties as being for "adults only" or to indicate preferred number of children.

**Occupancy standards** (the number of persons permitted to reside in a property) must be based on objective factors such as sanitation or safety. Landlords cannot restrict the number of occupants to eliminate families with children.

#### Disability

A *disability* is a physical or mental impairment. It is unlawful to discriminate against prospective buyers or tenants on the basis of disability. The term includes having a history of, or being regarded as having, an impairment that limits one or more of an individual's major life activities. Persons who have AIDS are protected by the fair housing laws under this classification.

Landlords must make reasonable accommodations to existing policies, practices, or services to permit persons with disabilities to have equal enjoyment of the premises. For instance, it would be reasonable for a landlord to permit service animals (such as guide dogs) in a normally "no-pets" building or to provide designated parking spaces for persons with disabilities.

People with **disabilities must be permitted to make reasonable modifications to the premises at their own expense**. Such modifications might include lowering door handles or installing bath rails for a person in a wheelchair. Failure to permit reasonable modification constitutes discrimination. However, the **law recognizes that certain reasonable modifications might make a rental property undesirable to the general population**. In such a case, the **landlord is allowed to require that the property be restored to its previous condition when the lease period ends**.

However, where it is necessary in order to ensure with reasonable certainty that funds will be available to pay for the restorations at the end of the tenancy, **the landlord may negotiate as part of such a restoration agreement a provision requiring that the tenant pay into an interest-bearing escrow account, over a reasonable period, a reasonable amount of money not to exceed the cost of the restorations**. The landlord may not increase the customarily required security deposit for persons with disabilities.

**The law does not prohibit restricting occupancy to persons with disabilities in dwellings that are designed specifically for their accommodation.**

In newly constructed multifamily buildings with an elevator and four or more units, the public and common areas must be accessible to persons with disabilities, and doors and hallways must be wide enough for wheelchairs. The entrance to each unit must be accessible, as well as the light switches, electrical outlets, thermostats, and other environmental controls. People in wheelchairs should be able to use the kitchen and bathrooms; bathroom walls should be reinforced to accommodate later installation of grab bars. Ground-floor units must meet these requirements in buildings that do not have an elevator. Licensees should be aware that state and local law may require stricter standards.

### **Exemptions to the Fair Housing Act**

The federal Fair Housing Act provides for **certain exemptions**. It is important for licensees to know in what situations the exemptions apply. However, licensees should be aware that no exemptions involve race and no exemptions apply when a real estate licensee is involved in a transaction (including when selling or leasing his own property).

The Fair Housing Act exempts:

- owner-occupied buildings with no more than four units,
- single-family housing sold or rented without the use of a real state licensee, and
- housing operated by organizations and private clubs that limit occupancy to members.
- The sale or rental of a single-family home is exempt when the home is owned by an individual who does not own more than three such homes at one time (and who does not sell more than one every two years),
- a real estate licensee is not involved in the transaction, and
- discriminatory advertising is not used.

**The rental of rooms or units is exempt in an owner-occupied one to four-family dwelling.**

Note that dwelling units owned by religious organizations may be restricted to people of the same religion if membership in the organization is not restricted on the basis of race, color, or national origin.

A private club that is not open to the public may restrict the rental or occupancy of lodgings that it owns to its members as long as the lodgings are not operated commercially.

The Fair Housing Act does not require that housing be made available to any individual whose tenancy would constitute a direct threat to the health or safety of other individuals or that would result in substantial physical damage to the property of others.

### **Housing for older persons**

While the Fair Housing Act protects families with children, certain properties can be restricted to occupancy by elderly persons. Housing intended for persons aged 62 or older or housing occupied by at least one person 55 years of age or older (where 80 percent of the units are occupied by individuals 55 or older) is exempt from the familial status protection.

## **FAIR HOUSING PRACTICES**

### **Blockbusting**

Blockbusting is the act of encouraging people to sell or rent their homes by claiming that the entry of a protected class of people into the neighborhood will have some sort of negative impact on property values. Any message, however subtle or accidental, that property should be sold or rented because the neighborhood is "undergoing changes" is considered blockbusting.

**It is illegal to suggest that the presence of certain persons will cause property values to decline, crime or antisocial behavior to increase, or the quality of schools to suffer.**

A critical element in defining blockbusting, according to HUD, is the profit motive. A property owner may be intimidated into selling his property at a depressed price to the blockbuster, who in turn sells the property to another person at a higher price. Blockbusting is also called **panic selling**. To avoid accusations of blockbusting, licensees should use good judgment when choosing locations and methods for marketing their services and soliciting listings.

### **Steering**

Steering is the **channeling of home-seekers to particular neighborhoods. It also includes discouraging potential buyers from considering some areas**. In either case, it is an illegal limitation of a purchaser's options.

In the rental process, steering occurs when the landlord puts members of a protected class on a certain floor or building. Another form of steering occurs when the **landlord tells a prospective tenant that no vacancy exists when, in fact, there is a vacancy**. When the misstatement is made on the basis of a protected class, the prospect is steered away from that building.

**Many cases of steering are subtle**, motivated by assumptions or perceptions about a homebuyer's preferences, and based on some stereotype. Such **assumptions about a buyer's preferences may be legally dangerous**. The licensee should never assume that prospective buyers "expect" to be directed to neighborhoods or properties. **Steering anyone is illegal**.

The **Illinois Real Estate License Act of 2000** expressly **prohibits** "Influencing or attempting to influence by any words or acts a prospective seller, purchaser, occupant, landlord, or tenant of real estate, in connection with viewing, buying or leasing of real estate, so as to promote, or tend to promote, the continuance or maintenance of racially and religiously segregated housing, or so as to retard, obstruct or discourage racially integrated housing on or in any street, block, neighborhood, or community."

## Advertising

**Advertisements of property for sale or rent may not include language indicating a preference or limitation. No exception to this rule exists, regardless of subtle or "accidental" wordings.** HUD's regulations cite numerous examples that are considered discriminatory. However, an advertisement that is gender-specific, such as "female roommate sought," is allowed as long as the advertiser seeks to share living quarters with **someone of the same gender**.

The media used for promoting property or real estate services must not target any one population to the exclusion of others. **The use of media that targets only certain groups based on, for example, language or geography, is also viewed as being potentially discriminatory.** For instance, limiting advertising to a cable television channel viewed mostly by one demographic group might be construed as discriminatory. The best rule is never to advertise using only one group of narrowly focused media. Running ads in several locales or in general-circulation media as a standard rule is good practice.

Many licensees choose to run a small version of the equal housing opportunity symbol in all of the materials that represent them, along with the words "equal housing opportunity" underneath. The fair housing symbol signals the world that one is open for business to anyone who is of age and financially able to purchase real estate.

## Appraising

Those who prepare appraisals or any statements of valuation whether they are formal or informal, oral, or written (including a competitive market analysis) may consider any normal qualifying factors that affect value. **However, race, color, religion, national origin, sex, disability, and familial status are factors that may not be considered.**

## Redlining

**The practice of refusing to make mortgage loans or issue insurance policies in specific areas for reasons other than the applicant's financial qualifications is known as redlining.** Redlining refers to literally or figuratively **drawing a line around particular areas**. Such practices contribute to the deterioration of older neighborhoods. Redlining is often based on racial grounds rather than on any real objection to an applicant's creditworthiness. Redlining means that the lender has made a policy decision that **no property in a certain area will qualify for a loan**, no matter who wants to buy it. The federal Fair Housing Act prohibits discrimination in mortgage lending and covers not only the actions of primary lenders but also activities in the secondary mortgage market. **A lending institution can, however, refuse a loan solely on sound, documentable financial grounds.**

The **Home Mortgage Disclosure Act** requires that all institutional mortgage lenders with assets in excess of \$36 million and one or more offices in a given geographic area **make annual reports**. The

**reports must detail all mortgage loans the institution has made or purchased, broken down by census tract.** This law enables the government to detect patterns of lending behavior that might constitute redlining.

### Intent and Effect

If an owner or real estate licensee **purposely sets out to engage in blockbusting, steering, or other unfair activities, the intent to discriminate is obvious.** However, owners and licensees must examine their activities and policies carefully to determine whether they unintentionally appear to engage in discriminatory actions. **Whenever policies or practices result in unequal treatment of persons in a protected class, they are considered discriminatory, regardless of intent.** This "effects test" is applied by regulatory agencies to determine whether discrimination has occurred.

### Response to Concerns of Terrorism

In response to the concern of future terrorist attacks, landlords and property managers have been developing new security procedures. These procedures have focused on protecting buildings and residents. Landlords and property managers are also educating residents on signs of possible terrorist activity and how and where to report it. At the same time, landlords and property managers need to ensure that their procedures and education do not infringe on the fair housing rights of others.

For screening and rental procedures, it is **unlawful to screen housing applicants on the basis of race, color, religion, sex, national origin, disability, or familial status.** According to HUD, landlords and property managers have been inquiring about whether they can screen applicants on the basis of citizenship status. The Fair Housing Act does not specifically prohibit discrimination based solely on a person's citizenship status. **Therefore, asking applicants for citizenship documentation or immigration status papers during the screening process does not violate the Fair Housing Act.** For many years, the federal government has been asking for these documents in screening applicants for federally assisted housing. There is, however, a specific procedure for collecting and verifying citizenship papers provided by HUD.

### ENFORCEMENT OF THE FAIR HOUSING ACT

The federal Fair Housing Act is administered by the Office of Fair Housing and Equal Opportunity (OFHEO) under the direction of the secretary of HUD. Any aggrieved person who believes illegal discrimination has occurred **may file a complaint with HUD within one year of the alleged act.** HUD may also initiate its own complaint. Complaints may be reported to the **Office of Fair Housing and Equal Opportunity, Department of Housing and Urban Development, Washington, DC 20410**, or to the Office of Fair Housing and Equal Opportunity in care of the nearest HUD regional office. Complaints may also be submitted directly to HUD using an online form available on the HUD Website.

On receiving a discrimination complaint:

- HUD initiates an investigation.
- Within 100 days of the filing of the complaint, HUD either determines that reasonable cause exists to bring a charge of illegal discrimination or dismisses the complaint.
- During this investigation period, HUD can attempt to resolve the dispute informally through conciliation. Conciliation is the resolution of a complaint by obtaining assurance that the person

against whom the complaint was filed (the respondent) will remedy any violation that may have occurred.

- Once a formal charge of discrimination has been filed, a formal hearing is required.
- Either the complainant or the respondent may force the hearing to district court by means of what is called an election, which must be made within 20 days after charges are issued.
- If no election is made, the case will be heard before a U.S. administrative law judge (ALJ who is an expert in housing discrimination).
- If either party prefers, then, by election, the case goes to a U.S. district court judge (no fair housing specialization, under the Department of Justice, and a jury trial may be requested).
- Cases under the ALJs normally proceed much more quickly than if they were heard in district court, and the fair housing expertise may be higher.
- The judge has the authority to award actual damages to the aggrieved person or persons and, if it is believed the public interest will be served, to impose monetary penalties. The penalties range from up to \$16,000 for a first offense to \$65,000 for a third violation within seven years.
- An ALJ also has the authority to issue an injunction to order the offender to either take action (such as rent an apartment to the complaining party) or refrain from an action (such as continuing to rent to only one group).
- The parties may elect civil action in federal court at any time within two years of the discriminatory act. For cases heard in federal court, unlimited punitive damages can be awarded in addition to actual damages. The court also can issue injunctions. **Errors and omissions insurance carried by licensees may not cover violations of the fair housing laws.**
- Whenever the attorney general has reasonable cause to believe that any person or group is engaged in a pattern or practice of resistance to the full enjoyment of any of the rights granted by the federal fair housing laws, he may file a civil action in any federal district court. The district court may award actual and punitive damages along with attorney's fees and costs.

**Complaints brought under the Civil Rights Act of 1866 are taken directly to federal courts. The only time limit for action is a state's statute of limitations for torts.**

### **Equal Credit Opportunity Act**

The federal Equal Credit Opportunity Act (ECOA) **prohibits discrimination based on race, color, religion, national origin, sex, marital status, or age in the granting of credit.** Note that ECOA protects more classes of persons than the Fair Housing Act. The **ECOA bars discrimination on the basis of marital status and age. It also prevents lenders from discriminating against recipients of public assistance programs, food stamps, or Social Security.**

The ECOA requires that credit applications be considered only on the basis of:

- income,
- net worth,
- job stability, and
- credit rating.

### Other Lending Prohibitions - Lending

- A creditor may not consider age unless the applicant is **too young to legally sign a contract, which is usually 18.**
- **the creditor may consider age when determining if income will drop due to retirement.**
- Lenders are prohibited from discriminating against **recipients of public assistance programs such as food stamps and Social Security.**
- Lenders may not ask questions about a spouse unless the spouse is also applying for credit (e.g., **lenders may not discount a woman's income or assume that she will leave the workforce to raise children).**

The agency that enforces ECOA depends on the type of financial institution. In general, the ECOA is enforced by the Federal Trade Commission (FTC) and the Department of Justice as well as other agencies.

### Americans with Disabilities Act

Although the **Americans with Disabilities Act (ADA)** is not a housing or credit law, it still has a significant effect on the real estate industry. The ADA is important to licensees because it **addresses the rights of individuals with disabilities in employment and public accommodations.** Real estate licensees are often employers, and real estate brokerage offices are public spaces. The ADA's goal is to enable individuals with disabilities to become part of the economic and social mainstream of society.

Title 1 of the ADA requires that **employers (including real estate licensees) make *reasonable accommodations* that enable an individual with a disability to perform essential job functions.** The provisions of ADA apply to any employer with 15 or more employees.

Title III of the ADA requires that **individuals with disabilities have full accessibility to businesses, goods, and public services.** While the federal civil rights laws have traditionally been seen as focused on residential housing, **business and commercial real estate are fully covered by Title III.** Because people with disabilities have the right to full and equal access to businesses and public services under the ADA, **building owners and managers must ensure that any obstacle restricting this right is eliminated.** The Americans with Disabilities Act Accessibility Guidelines (ADAAG) contain **detailed specifications for designing parking spaces, curb ramps, elevators, drinking fountains, toilet facilities, and directional signs to ensure maximum accessibility.**

### ADA and the Fair Housing Act

All properties have exemptions, whether the property falls under the Fair Housing Act or properties that are exempt from the Fair Housing Act.

Some properties are subject to both laws. For example, in an apartment complex, **the rental office is a place of public accommodation. As such, it is covered by the ADA and must be accessible to persons with disabilities.**

**Individual rental units would be covered by the Fair Housing Act. A tenant who wished to modify the unit to make it accessible would be responsible for the cost.**



### **The Illinois Human Rights Act**

The Illinois Real Estate License Act of 2000 **prohibits any action that constitutes a violation of the Illinois Human Rights Act. This is true regardless of whether a complaint has been filed with or adjudicated by the Human Rights Commission.** The Illinois Human Rights Act includes some prohibitions that also are specifically addressed by the Real Estate License Act of 2000.

**Under the Illinois Human Rights Act, it is a civil rights violation for any licensee to engage in any of the following acts of discrimination based on:**

- Race,
- Color,
- Religion,
- National origin,
- Ancestry,
- Age,
- Sex,
- Marital status,
- Physical or mental disability,
- Military service,
- Unfavorable discharge from military service,
- Familial status,
- Sexual orientation,
- Order of protection status in connection with employment
- Real estate transactions
- Access to financial credit
- Availability of public accommodations

### **Specific Acts of Discrimination which are prohibited:**

- Refuse to engage in a real estate transaction with a person
- Alter the terms, conditions, or privileges of a real estate transaction
- Refuse to receive or fail to transmit an offer
- Refuse to negotiate
- Represent that real property is not available for inspection, sale, rental, or lease when in fact it is available; or fail to bring a property listing to an individual's attention; or refuse to permit him to inspect real estate
- Offer, solicit, accept, use, or retain a listing of real property with knowledge that unlawful discrimination is intended
- Publicize, through any means or use, an application form that indicates an intent to engage in unlawful discrimination

**The Illinois Human Rights Act defines elderly person as "the chronological age of a person who is at least 40 years old."**

It is a civil rights violation for the owner or agent of any housing accommodation to engage in any of the following discriminatory acts **against children**:

- Require, as a condition to the rental of a housing accommodation, that the prospective tenant shall **not have one or more children under 18 residing in his family at the time the application for rental is made**
- Insert a condition in any lease that **terminates the lease if one or more children younger than age 18 are ever in the family occupying the housing**. Any agreement or lease that contains a condition such as the above is "legally void as to that condition"; the **lease itself remains in force, but the clause is void and unenforceable**

**It is also a civil rights violation in Illinois to discriminate against any person who is blind, hearing-impaired, or physically disabled in the terms, conditions, or privileges of sale or rental property.**

Similarly, it is a civil rights violation to refuse to sell or rent to a prospective buyer or tenant because he has a service animal. A seller or landlord may not require the inclusion of any additional charge in a lease, rental agreement, or contract of purchase or sale because a person who is blind, hearing-impaired, or physically disabled and has a service animal. **Of course, the tenant may be liable for any actual damage done to the premises by the animal.**

### **Exemptions:**

Certain individuals, property types, and transactions are exempt from the anti-discriminatory provisions of the Illinois Human Rights Act:

- Private owners of single-family homes if (1) they own fewer than three single-family homes (including beneficial interests); (2) they were (or a member of their family was) the last current resident of the home; (3) the home was sold without the use of a real estate licensee; and (4) the home was sold without the use of discriminatory advertising
- Owner-occupied apartment buildings of five units or less
- Private rooms in a private home occupied by an owner or owner's family member
- Reasonable local, state, or federal restrictions regarding the maximum number of occupants permitted to occupy a dwelling
- A religious organization, association, or society (or any nonprofit institution or organization operated, controlled, or supervised by or in conjunction with a religious organization, association, or society) may limit the sale, rental, or occupancy of dwellings owned or operated by it (for other than commercial reasons) to persons of the same religion or give preference to persons of the same religion. This exemption is limited; it does not apply if membership in the religion is restricted on account of race, color, or national origin.
- Restricting the rental of rooms in a housing accommodation to persons of one sex
- Appraisers may take into consideration any factors other than those based on unlawful discrimination or familial status in furnishing appraisals.
- Individuals who have been convicted by any court of illegally manufacturing or distributing controlled substances.
- Housing for older persons on the basis of familial status.

- A child sex offender who owns residential real estate, in which the offender lives and rents, is exempt from renting a unit in that property to a person who is the parent or guardian of a child or children under 18 years of age. (P.A. 95-42, eff. 8-10-07; 95-820, eff. 1-1-09).

### **Illinois Sexual Harassment Law 775ILCS5/2-101(E)**

"Sexual harassment" means any unwelcome sexual advances or request for sexual favors or any conduct of a sexual nature when (1) submission to such conduct is made either explicitly or implicitly a term or condition of an individual's employment (2) submission to or rejection of such conduct by an individual is used as a basis for employment decisions affecting such individual, or (3) such conduct has the purpose or effect of substantially interfering with an individual work performance or creating an intimidating hostile or offensive work environment.

#### **What is considered sexual harassment?**

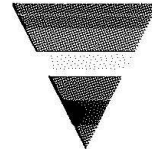
1. Sexually charged comments, sexual innuendos, sexual jokes, comments about your physical appearance or specific body parts, professions of feelings, and being asked out on a date can all constitute sexual harassment. Of course, you would have to show that such comments and behavior was unwanted and that you were not a willing participant.
2. Unwanted physical contact such as touching, groping, hugging, grazing up against. Again, it is important to show that this type of physical contact was unwanted and made you feel uncomfortable.
3. Making any part of your job (such as wages, promotions, references or working conditions) any part of your housing (such as your rent, your security deposit or lease renewal), or any part of your educational performance (such as grades, honors, course work, or scholarships) contingent on submission to sexual behavior.
4. Sexual harassment can include the display of sexually suggestive objects, signs, magazines, or pictures, or the sending of sexually suggestive emails or text messages to persons who do not want this attention.



State of Illinois  
Department of Human Rights



## YOUR RIGHT TO EQUAL HOUSING



### **What is Housing Discrimination?**

Housing discrimination occurs when the right to equal housing access is denied or when people are treated differently in housing based on a particular characteristic that is protected under the law.

Under the Illinois Human Rights Act, you are entitled to choose where to live and to fully enjoy the use of the facilities of the unit without unlawful discrimination. The Act also prohibits discrimination in the sale or rental of real property (including commercial property).

### **Types of Discrimination:**

The Illinois Department of Human Rights investigates discrimination complaints in the following areas:

- Employment
- Real Estate Transactions
- Financial Credit
- Public Accommodations
- Sexual Harassment in Education

Under the Illinois Human Rights Act, it is illegal to discriminate on the basis of the following **protected classes**:

- Race, Color
- National Origin
- Religion
- Sex, Pregnancy
- Ancestry
- Sexual Harassment
- Age (Over 40)
- Marital Status
- Disability
- Military Status

#### **• Sexual Orientation (including gender-related identity)**

- Unfavorable Military Discharge
- Order of Protection Status
- Familial status (children under 18) in real estate transactions
- Arrest record, citizenship status and language (in employment)
- Coercion, intimidation and retaliation are also prohibited

### **Who Does the Law Apply To?**

In real estate transactions, the law applies to owners, managers, salespersons, brokers, rental agents, or other agents or employees of the owner or the owner's agents. Newspapers and other publications that print discriminatory advertising can also be charged under the Act. Houses, apartments, condominiums, mobile home parks, vacant land, offices, stores and other types of residential and commercial property are covered.

### **Prohibited Activity:**

The following are examples of housing discrimination based on sexual orientation or gender identity:

- Refusal to engage in a real estate transaction:  
*Refusing to rent or refusing an offer to buy because someone is gay; or taking the property in question off the market so that a gay couple is not able to buy or rent it.*
- Misrepresenting the availability of real property:  
*Lying about the availability of property that is up for inspection, sale, rental, or lease when the property owner finds out the applicant is lesbian.*
- Failure to make property listings available:  
*Failing to tell someone about available property because the real estate agent believes the applicant is transgender.*
- Publication of intent:  
*Publishing or displaying an ad expressing intent to engage in unlawful discrimination, such as saying that children are not allowed or straight couples are preferred.*
- Alteration of terms or conditions in property or real estate transactions:  
*Treating people differently in terms of rent amounts, maintenance services, reasons for termination, etc., because of sexual orientation.*
- Sexual Harassment:  
*Asking for sexual favors as a condition for sale or rental, or engaging in other verbal or physical conduct of a sexual nature that creates an intimidating, hostile or offensive environment.*

**(OVER→)**

U. S. Department of Housing and Urban Development



**EQUAL HOUSING  
OPPORTUNITY**

**We Do Business in Accordance With the Federal Fair  
Housing Law**

(The Fair Housing Amendments Act of 1988)

**It is illegal to Discriminate Against Any Person  
Because of Race, Color, Religion, Sex,  
Handicap, Familial Status, or National Origin**

- |  |  |
|--|--|
| ■ In the sale or rental of housing or residential lots | ■ In the provision of real estate brokerage services |
| ■ In advertising the sale or rental of housing         | ■ In the appraisal of housing                        |
| ■ In the financing of housing                          | ■ Blockbusting is also illegal                       |

Anyone who feels he or she has been discriminated against may file a complaint of housing discrimination:

1-800-669-9777 (Toll Free)

1-800-927-9275 (TTY)

**U.S. Department of Housing and  
Urban Development  
Assistant Secretary for Fair Housing and  
Equal Opportunity  
Washington, D.C. 20410**

## IMPLICATIONS FOR REAL ESTATE LICENSEES

The real estate industry **is largely responsible for creating and maintaining an open housing market**. Licensees are a community's real estate experts. Along with the privilege of profiting from real estate transactions **comes the social and legal responsibilities to ensure that everyone's civil rights are protected**.

**Fair housing is the law. The consequences for anyone who violates the law are serious. In addition to the financial penalties, a licensee's livelihood will be in danger if his license is suspended or revoked.** That the offense was unintentional is no defense. Licensees must scrutinize their practices with care and not fall victim to clients or customers who maneuver to discriminate. All parties deserve the same standard of service. Every future homeowner has the right to expect fair and equal treatment, with house showings based only on his stated needs and financial capability. A good test is to answer the question, **"Are we providing this service for everyone?"**

Standardized inventories of property listings, standardized criteria for financial qualification, and written documentation of activities and conversations (especially if the licensee senses a client wishes to act in a discriminatory way) are three effective means of self-protection for licensees.

**HUD requires that its fair housing posters be displayed in any place of business where real estate is offered for sale or rent.** Following HUD's advertising procedures and using the fair housing slogan and logo bolsters public awareness of the licensee's commitment to equal opportunity.

## Professional Ethics

**Ethics refers to a high moral system of principles, rules, and standards based on conduct and values.** The ethical system of a profession establishes guidelines that reach to the higher principles of what is "right." Those principles may form the law, but they exist apart from the law. Professional ethics in business usually focus on two main aspects of the profession:

- They establish standards for integrity and competence in dealing with consumers of an industry's services.
- They define a code of conduct for relations within the industry and among its professionals.

## Code of Ethics

One way that many organizations address ethics among their members or in their respective businesses is by **adopting specific, written codes of ethical conduct**. A code of ethics is a written system of standards for professional, values-based conduct. The code contains statements designed to advise, guide, and regulate job behavior. To be effective, a code of ethics must be specific by creating rules that either prohibit or encourage certain behaviors. By including sanctions for violators, a code of ethics becomes more effective.

The National Association of REALTORS® (NAR), the largest trade association in the country with over one million members, adopted a code of ethics for its members in 1913. REALTORS® are expected to subscribe to this strict code of conduct. Not all licensees are REALTORS® only those who are members of NAR. NAR has established procedures for professional standards committees at the local, state, and national levels of the organization to administer compliance. Practical applications of the articles of the code are known as Standards of Practice.

**NOTES:**

[illegible]

## CHAPTER 15: PROPERTY MANAGEMENT & LEASING

### THE MANAGEMENT PROFESSION

Most metropolitan areas have local associations of building and property owners and managers that are affiliates of regional and national associations. All of these professional organizations provide information and contacts for all aspects of property management. Here is a list of some well-known associations:

- Building Owners and Managers Association International (BOMA): commercial real estate
- Building Owners and Managers Institute International (BOMI): education programs for commercial property and facility management industries
- Community Associations Institute (CAI): homeowners' associations, condominiums, and other planned communities
- Institute of Real Estate Management (IREM): multifamily and commercial real estate designation
- International Council of Shopping Centers (ICSC): shopping centers worldwide
- National Apartment Association (NAA): multifamily housing industry
- National Association of Home Builders (NAHB): all aspects of home building
- National Association of Residential Property Managers (NARPM): single-family and small residential properties.

### THE PROPERTY MANAGER

In addition to leasing, managing, marketing, and overall maintenance of real estate owned by others, it is also expected that a property manager function as a market analyst, residential leasing agent, accountant, advertising specialist, and maintenance person all in the same day. In addition, the property manager frequently interacts with people in various professions, including lawyers, environmental engineers, and accountants.

The property manager has three principal responsibilities:

- Achieve the objectives of the property owners
- Generate income for the owners
- Preserve and/or increase the value of the investment property

**Some property managers work for property management companies.** These firms manage properties for a number of owners under management agreements (discussed later). Other property managers are independent. The property manager has an agency relationship with the owner, which involves greater authority and discretion over management decisions than an employee would have. **Illinois property managers must be licensed managing brokers**, under a Sponsoring Broker, because they engage in collecting rent, negotiating leases and rentals, and procuring tenants, among other functions.

However, the Illinois Real Estate License Act of 2000 specifically exempts resident managers of apartment buildings, duplexes, and apartment complexes from licensure requirements when their primary residence is on the premises being managed.



Illinois permits individuals whose real estate practice is limited to leasing or renting residential property, collecting rent, negotiating leases, and similar activities to obtain a residential leasing-agent license instead of the broader-scope broker or managing broker license. An individual with a residential leasing-agent license must be sponsored by a sponsoring broker.

## **Securing Management Business**

Possible sources of a property management business include:

- Corporate owners,
- Apartment buildings,
- Owners of small rental residential properties,
- Homeowners' associations,
- Investment syndicates,
- Trusts, and
- Owners of office buildings.

## **PROPERTY MANAGER'S RESPONSIBILITIES**

### **Financial Reports**

One of the primary responsibilities of a property manager is maintaining financial reports, including an operating budget, cash flow report, profit and loss statement, and budget comparison statement.

### **Operating budget**

An operating budget is the **projection of income and expense for the operation of a property over a one-year period**. This budget, developed before attempting to rent property, is based on anticipated revenues and expenses and provides the owner the amount of anticipated profit. The property manager and owner use the operating budget as a guide for the property's financial performance in the present and future.

### **Income**

Income includes gross rentals collected, delinquent rental payments, utilities, vending contracts, late fees, and storage charges. Any losses from uncollected rental payments or evictions are deducted from the total gross to arrive at the total adjusted income.

### **Expenses**

Fixed and variable expenses include administrative costs (including building personnel), operating expenses, and maintenance costs. Fixed expenses that remain constant and do not change include employee wages, utilities, and other basic operating costs. Variable expenses may be recurring or nonrecurring and can include capital improvements, building repairs, and landscaping.

### **Cash flow report**

**A cash flow report is a monthly statement that details the financial status of the property.**

Sources of income and expenses are noted, as well as net operating income, and net cash flow. **The cash flow report is the most important financial report because it provides a picture of the current financial status of a property.**

The formula for arriving at cash flow is as follows:

- Gross rental income plus other income less losses incurred = **Total Income**
- Total income less operating expenses = **Net Operating Income before debt service** (e.g., mortgage payments)
- Net operating income before debt service less debt service less reserves = **Cash flow**

### **Profit and loss statement**

This is a financial picture of the revenues and expenses used to determine whether the business has made money or suffered a loss. The statement is created from the monthly cash flow reports and does not include itemized information.

A formula for profit and loss statement looks like this:

Gross receipts, minus expenses, minus total mortgage payments (which includes Principal and Interest) = **net profits**

### **Budget comparison statement**

The budget comparison statement compares the actual results with the original budget, often giving either percentages or a numerical variance of actual versus projected income and expenses.

## **NEW OPPORTUNITIES**

### **Community Association Management**

The prevalence of homeowners' and condominium associations, combined with complex planning and development codes, have placed new demands on property managers. Working as part of a team, property managers assist in providing a comprehensive array of services to volunteer boards.

### **The Illinois Community Association Manager Licensing and Disciplinary Act was created:**

- to provide for the regulation of managers of community associations,
- to ensure that managers are qualified to engage in community association management,
- to provide for high standards of professional conduct by those licensed.

**Anyone acting under this license cannot perform any activities for which a real estate broker's license is required under the Illinois Real Estate License Act of 2000.**

### **Resort Housing**

**Managing second-home and resort rentals presents specific challenges.** These managers must be able to care for and maintain often-vacant properties and be able to attract and manage short-term tenants.

### **Housing for the near-elderly and elderly**

Opportunities abound in managing housing for the **near-elderly and elderly, many of which are federally assisted housing programs.** Since subsidized housing is involved, these property managers need to be **familiar with state and federal rules pertaining to eligibility requirements and income verification.**

## Manufactured Homes

Homes built in factories meeting HUD specifications are called **manufactured homes** (incorrectly, mobile homes). These homes are permanently attached to concrete pads or foundations. They can be placed on individual lots or in Manufactured Home Communities. They are taxed as Real Estate.

## Mobile Homes

These homes are designed to be towed from place to place, and as a result consist of lighter construction which does not age well. Some mobile homes are located in Mobile Home Parks or Communities and are not moved once they are placed on a lot. They are normally not permanently attached to the land and as such, are taxed as personal property. The majority of these lots are rented (day, week, month, year) but some are purchased by the mobile homeowner.

## Concierge Services

A new area for property managers to specialize in is the **training and managing of concierge staff for office buildings and other settings**. Concierge staff is responsible for anything from arranging for taxi rides to assisting with visual aid equipment for a conference.

## Asset Management

**Asset managers monitor a portfolio of properties similar to a securities portfolio by analyzing the performance of the properties and making recommendations to the owners of the properties.** Real property asset management helps clients decide what type of real estate to invest in (commercial or residential), which property is best to purchase, the best financial sources for a real estate purchase, and when to dispose of property.

## Corporate Property Managers

**Corporate property managers manage properties for corporations that invest in real estate or medium and large-sized companies that have a large number of real estate properties for corporate operations.** Typically, corporate property managers are employees of the corporation and not independent contractors.

## Residential Leasing Agents

Residential Leasing agents are usually independent contractors working for a Sponsoring Broker on a commission basis and are in high demand because of their skill in securing lessees.

## THE MANAGEMENT PLAN AND AGREEMENT

### The Management Plan

Property management begins with a **management plan** prepared by the property manager. **A management plan outlines the details of the owner's objectives with the property, as well as what the property manager expects to accomplish and how, including all financial objectives.**

In preparing a management plan, a property manager analyzes three factors:

- the owner's objectives,
- the regional and neighborhood market,
- the specific property.

Occupancy, absorption rates, and new starts are critical indicators. The plan also includes a budgetary section on sources of revenue and anticipated expenses.

### **The Management Agreement**

The first step in taking over the management of any property is to **enter into a management agreement with the owner. This agreement creates a general agency relationship between the owner and the property manager.** It defines the duties and responsibilities of each party. It is also a guide used in operating the property as well as a reference in case of future disputes.

**Like any other contract involving real estate, the management agreement should be in writing. It should include the following:**

- **Description of the property.** This should include the street address of the property as well as the legal description.
- **Time period the agreement covers.** This would include specific provisions for termination.
- **Definition of the management's responsibilities.** All the manager's duties should be specifically stated in the contract. Any limitations or restrictions on what the manager may do should be included.
- **Statement of the owner's purpose.** The owner should clearly state what the manager is to accomplish. One owner may want to maximize net income, while another will want to increase the capital value of the investment. Long-term goals are often key.
- **Extent of the manager's authority.** This provision should state what authority the manager is to have in matters such as hiring, firing, and supervising employees, fixing rental rates for space, and making expenditures and authorizing repairs. Repairs that exceed a certain expense limit may require the owner's written approval.
- **Reporting.** The frequency and detail of the manager's periodic reports on operations and financial position should be agreed on. These reports serve as a means for the owner to monitor the manager's work and operational trends; they form a basis for shaping management policy.
- **Management fee.** The fee may be based on a percentage of gross or net income, a fixed fee, or some combination of these and other factors. The fee must be negotiated between the property manager and the principal. In addition, the property manager may be entitled to a commission on new rentals and renewed leases.
- **Allocation of costs.** The agreement should state which of the property manager's expenses - such as office rent, office help, telephone, advertising, and association fees - will be paid by the manager. Other costs will be paid by the owner.
- **Antitrust provisions.** Management fees are subject to the same antitrust considerations as sales commissions.
- **Equal opportunity statement.** Residential property management agreements should include a statement that the property will be shown, rented, and otherwise made available to all persons protected by state or federal law.

## RENTING THE PROPERTY

### Setting rental rates

Rental rates are **influenced primarily by supply and demand**. The property manager should conduct a detailed survey of the competitive space available in the neighborhood, emphasizing similar properties. In establishing rental rates, the property manager has four long-term considerations:

- The rental income must be sufficient to cover the property's fixed charges and operating expenses.
- The rental income must provide a fair return on the owner's investment.
- The rental rate should be in line with prevailing rates in comparable buildings in the area. It may be slightly higher or slightly lower, depending on the strength of the property.
- The current vacancy rate in the property is a good indicator of how much of a rent increase is advisable. A building with a low vacancy rate is a better candidate for an increase than one with a high vacancy rate.

A rental rate for residential space is usually stated as the monthly rate per unit. Commercial leases including office, retail, and industrial space rentals are usually stated according to annual rates per square foot.

**An elevated level of vacancy may indicate poor management or a defective or an undesirable property.** On the other hand, **a high occupancy rate may mean that rental rates are too low**.

### Collecting rents

A property manager should accept only those tenants who can be expected to meet their financial obligations. In addition to contacting credit bureaus, the selection process involves calling financial references and, if possible, interviewing the former landlord. **Eviction history is now also checked.**

The terms of rental payment should be spelled out in the lease agreement, including:

- time and place of payment,
- provisions and penalties for late payment and returned checks, and
- provisions for cancellation and damages in case of nonpayment.

The property manager should establish a firm and consistent collection plan. **The plan should include a system of notices and records that complies with state and local law.**

Every attempt must be made to collect rent without resorting to legal action. Legal action is costly and time-consuming and does not contribute to good tenant relations. **When it is unavoidable, legal action must be taken in cooperation with the property owner's or management firm's legal counsel. In Illinois, specific legal procedures must be followed in taking legal action against a tenant.**

In addition, Illinois law has specific provisions regarding the maintenance and payment of interest on security deposits. Property managers (who must have broker or managing broker licenses) must put security deposits in a special escrow account, in the same way that real estate licensees must handle earnest money. The security deposits must be deposited in the escrow account by the next

business day after a lease is signed, and this must be recorded in the journal and ledger. This escrow account is a non-interest-bearing account unless the property is residential with 25 or more units, in which case interest must be paid to the tenants.

### **Maintaining Good Relations with Tenants**

An effective property manager establishes a good communication system with tenants. Regular newsletters or posted memoranda help keep tenants informed and involved. Maintenance and service requests must be attended to promptly, and all lease terms and building rules must be enforced consistently and fairly.

**The property manager must be able to handle residents who do not pay their rents on time or who break building regulations.** Careful record keeping shows whether rent is remitted promptly and in the proper amount. Records of all lease renewal dates should be kept so that the manager can anticipate expiration and retain good tenants who otherwise might move when their leases end.

### **Maintaining the Property**

One of the most important functions of a property manager is the **supervision of property maintenance**. A manager must learn to balance services provided with their costs that is, to satisfy tenants' needs while minimizing operating expenses.

To maintain the property efficiently, the manager must be able to assess the building's needs and how best to meet them. In some cases, the best plan may be to operate a low-rental property with minimal expenditures for services and maintenance. Another property may be more lucrative if kept in top condition and operated with all possible tenant services. A well-maintained, high-service property can command premium rental rates.

A primary maintenance objective is to protect the physical integrity of the property over the long term. For example, preserving the property by repainting the exterior or replacing the heating system helps decrease long-term maintenance costs. Keeping the property in good condition involves the following four types of maintenance:

- Preventive maintenance
- Repair or corrective maintenance
- Routine maintenance
- Construction

### **Preventive Maintenance**

**This includes regularly scheduled activities such as painting and seasonal servicing of appliances and systems.** Preventive maintenance preserves the long-range value and physical integrity of the building. This is both the most critical and the most neglected maintenance responsibility. Failure to perform preventive maintenance invariably leads to greater expense in other areas of maintenance.

## **Repair or Corrective Maintenance**

**This involves the actual repairs that keep the building's equipment, utilities, and amenities functioning.** Repairing a boiler, fixing a leaky faucet, or mending a broken air-conditioning unit are acts of corrective maintenance.

## **Routine Maintenance**

**Routine maintenance includes such day-to-day duties as cleaning common areas, performing minor carpentry and plumbing adjustments, and providing regularly scheduled upkeep of landscaping.** Good routine maintenance is similar to good preventive maintenance. Both head off problems before they become expensive.

One of the major decisions a property manager faces is whether to contract for maintenance services from an **outside firm or hire on-site employees** to perform such tasks. This decision should be based on a number of factors, including:

- Size of the building,
- Complexity of the tenants' requirements, and
- Availability of suitable labor.

## **CONSTRUCTION**

A commercial or an industrial property manager often is called on to make **tenant improvements** (sometimes referred to as TI). These are **alterations to the interior of the building to meet a tenant's particular space needs**. Such construction alterations range from simply repainting or recarpeting to completely gutting the interior and redesigning the space by erecting new walls, adding partitions, and revamping electrical systems.

**In new construction, especially, the interiors are usually left incomplete so that they can be adapted to the needs of individual tenants.** One matter that must be clarified is which improvements will be considered *trade fixtures* (personal property belonging to the tenant) and which will belong to the owner of the real estate.

**Modernization or renovation of buildings that have become functionally obsolete and thus unsuited to today's building needs is also important.** The renovation of a building often enhances marketability and potential income.

## **Handling Environmental Concerns**

**Managers may manage structures containing asbestos or radon or be called on to arrange an environmental audit of a property.** Managers must see that any hazardous wastes produced by their employees or tenants are properly disposed of. Even nonhazardous waste of an office building must be controlled to avoid violation of laws requiring segregation and recycling of types of wastes.

**Air quality issues are a key concern for those involved in property management and design.** Building related illness (BRI) and sick building syndrome (SBS) are illnesses that are more prevalent today because of energy and efficiency standards used in construction that make buildings more airtight with less ventilation. SBS is more typical in an office building.

## THE AMERICANS WITH DISABILITIES ACT

Title I of the ADA provides for the employment of qualified job applicants regardless of their disability.

**Any employer with 15 or more employees must adopt nondiscriminatory employment procedures.** In addition, employers must make reasonable accommodations to **enable individuals with disabilities to perform essential job functions.**

**Title III of the ADA prohibits discrimination in commercial properties and public accommodations.** The ADA requires that managers ensure that people with disabilities have full and equal access to facilities and services.

The ADA recommends ***reasonably achievable accommodations*** to provide access to the facilities and services. **New construction and remodeling, however, must meet higher standards because new design costs less than retrofitting.** An unexpected benefit to new owners is that many of the accessible design features and accommodations benefit everyone.

**Existing barriers must be removed when this can be accomplished in a readily achievable manner that is, with little difficulty and at low cost.**

The following are typical examples of readily achievable modifications:

- Ramping or removing an obstacle from an otherwise accessible entrance
- Lowering wall-mounted public telephones
- Adding raised letters and Braille markings on elevator buttons
- Installing auditory signals in elevators
- Reversing the direction in which doors open (for wheelchair accessibility)
- Providing doors that have mechanisms that will open and close the doors automatically

## CIVIL RIGHTS LAWS

The Illinois Human Rights Act extends the list of protected classes for Illinois. It states as the public policy of Illinois and purpose of the act: "Freedom from unlawful discrimination. To secure for all individuals within Illinois the freedom from discrimination against an individual because of his or her race, color, religion, sex, national origin, ancestry, age, marital status, physical or mental disability, familial status, military status, unfavorable discharge from military service, or sexual orientation and order of protection status in connection with employment, real estate transactions, access to financial credit, and the availability of public accommodations." Article 3 of this act deals with real estate transactions.

## LEAD-BASED PAINT

The **1996 federal Lead-Based Paint Hazard Reduction Act Title X** focused more strongly on disclosure and REALTOR® liability. This federal law supersedes any state laws that are not as strong.

Real estate licensees leasing properties built before 1978 must ensure that landlords disclose any possible lead-based paint or related hazards. This disclosure form must be completed even in the case of an oral lease agreement. Once an offer for lease is received, the licensee representing the lessor (landlord) must make certain a completed Disclosure of Information (from landlord) and Acknowledgment Form (from tenant) are attached, showing that the disclosure requirements were met.



Finally, a federal lead hazard information pamphlet, obtained through the National Lead Information Clearinghouse at 800-424-LEAD (5323), must be distributed before leasing the property.

The Illinois Lead Poisoning Prevention Act requires that the owner of any residential building cited by the state as a lead paint hazard give prospective tenants written notice of the danger unless the owners have a certificate of compliance. This act is bolstered in its scope by the federal legislation noted earlier. When a mitigation order is issued to an owner of a building containing lead hazards, the owner has 90 days to eliminate the hazard in a manner prescribed by state law, or 30 days if occupied by a child under age six or by a pregnant woman.

## RISK MANAGEMENT

The perils of any risk must be evaluated in terms of options. In considering the possibility of a loss, the property manager must decide whether it is better to:

- **avoid** risk, by removing the source of risk (for instance, a swimming pool may pose an unacceptable risk if a daycare center is located in the building),
- **control** risk, by preparing for an emergency before it happens (e.g., by installing sprinklers, fire doors, and security systems),
- **transfer** risk, by shifting the risk onto another party (that is, by taking out an insurance policy),
- **retain** risk, by deciding that the chances of the event occurring are too small to justify the expense of any other response (an alternative might be to take out an insurance policy with a large deductible, which is usually considerably less expensive).

## Security of Tenants

**The physical safety of tenants of the leased premises is an important issue for property managers and owners.** Recent court decisions in several parts of the country have held **owners and their agents responsible for physical harm that was inflicted on tenants by intruders.** These decisions have prompted property managers and owners to think about how **to protect tenants and secure apartments from intruders.**

## Types of Insurance

**Insurance is one way to protect against losses.** Many types of insurance are available. An insurance audit should be performed by a competent, reliable insurance agent who is familiar with insurance issues for the type of property involved. The audit will indicate areas in which greater or lesser coverage is recommended and will highlight particular risks.

Some common types of coverage available to income property owners and managers include the following:

- **Fire and hazard:** Fire insurance policies provide coverage against direct loss or damage to property from a fire on the premises. Standard fire coverage can be extended to include other hazards such as windstorm, hail, smoke damage, or civil insurrection.
- **Consequential loss, use, and occupancy:** Consequential loss insurance covers the results, or consequences, of a disaster. Consequential loss can include the loss of rent or revenue to a business that occurs if the business's property cannot be used.

- **Contents and personal property:** This type of insurance covers building contents and personal property during periods when they are not actually located on the business premises.
- **Liability:** Public liability insurance covers the risks an owner assumes whenever the public enters the building. A claim paid under this coverage is used for medical expenses by a person who is injured in the building as a result of the owner's negligence. Claims for those hurt in the course of their employment are covered by state laws known as **workers' compensation acts**. (A building owner who is an employer must obtain a workers' compensation policy from a private insurance company).
- **Casualty:** Casualty insurance policies include coverage against theft, burglary, vandalism, and machinery damage as well as health and accident insurance. Casualty policies are usually written on specific risks, such as theft, rather than being all-inclusive.
- **Surety bonds:** Surety bonds cover an owner against financial losses resulting from an employee's criminal acts or negligence while performing assigned duties.

Many insurance companies offer **multi-peril policies** for apartment and commercial buildings. Such a policy offers the property manager a "**package**" of **standard commercial coverages, such as fire, hazard, public liability, and casualty**. Special coverage for earthquakes and floods is also available.

**Insurance for the personal property of tenants is also available to tenants.** Many tenants do not realize that if a property burns, their personal property is usually not covered by the landlord's policy. **(In Illinois, the policy type tenants should ask for is HO-4, designed specifically to cover renters' personal property).**

## Claims

Two possible methods can be used to determine the amount of a claim under an insurance policy. One is the **depreciated, or actual, cash value of the damaged property**. That is, the property is not insured for what it would cost to replace it but rather for what it was originally worth, *less the depreciation in value* that results from use and the passage of time. The other method is **current replacement cost**. In this sort of policy, the building or property is insured for what it would cost to rebuild or replace it today.

As with homeowners' policies, commercial policies include **coinsurance clauses that require the insured to carry fire coverage, usually in an amount equal to 80 percent of a building's replacement value**. If the coinsured amount is met on a policy guaranteeing replacement cost, it may mean that if a property is destroyed, the insured can collect more than the stated appraised value on the property.

## LEASES

### Leasing Real Estate

**A lease is a contract between an owner of real estate (the lessor) and a tenant (the lessee).** it is a contract to transfer the lessor's rights to exclusive possession and use of the property to the tenant for a specified period of time. The landlord receives **payment for use of the premises** and retains a **reversionary right to possession after the lease term expires**. The lessor's interest is called a *leased fee estate plus reversionary right*.

The **statute of frauds in Illinois** requires that lease agreements be in writing to be enforceable if they are for more than one year. The written rule also applies to leases for one year or less that will not be performed within one year of the contract date. Verbal leases for one year or less that can be performed within a year of their making are enforceable. Written leases should be signed by both lessor and lessee.

### **Leasehold Estates**

A tenant's right to possess real estate for the term of the lease is called a leasehold (less-than-freehold) estate. **A leasehold is generally considered personal property. Just as there are several types of freehold (ownership) estates, there are different kinds of leasehold estates.**

### **Estate for Years**

An **estate** (tenancy) **for years** is a leasehold estate that continues for a **definite** period of time. That period may be **years, months, weeks, or even days**. An estate for years (sometimes referred to as fixed-term tenancy) always has **specific beginning and ending dates**.

When the estate expires, the lessee is required to vacate the premises and surrender possession to the lessor. **No notice is required to terminate the estate for years because the lease agreement states a specific expiration date.** When the expiration date comes, the lease expires, and the tenant's rights are extinguished.

As is characteristic of all leases, a tenancy for years gives the lessee the **right to occupy and use the leased property according to the terms and covenants contained in the lease agreement**. It must be remembered that a lessee has the right to use the premises for the entire lease term. **That right is unaffected by the original lessor's death or sale of the property unless the lease states otherwise.** If the original lease provides for an option to renew, no further negotiation is required: the tenant merely exercises his option.

**Tenancy for years = Any definite period**

### **Estate from Period to Period**

An estate from period to period, or periodic tenancy, is created when the landlord and tenant enter into an agreement for an indefinite time. That is, the lease does not contain a specific expiration date. A periodic tenancy is characterized by continuity because it is automatically renewable when rent is paid under the original terms of the agreement until one of the parties gives notice to terminate. In effect, the payment and acceptance of rent extend the lease for another period.

**Periodic tenancy = Indefinite term; automatically renewing**

### **Periodic Tenancy - After Estate for Years Tenancy Expires**

An estate from period to period also might be created when a tenant with an estate for years remains in possession, or holds over, after the lease term expires. If no new lease agreement has been made, a **holdover tenancy** is created. The landlord's acceptance of rent usually is considered conclusive proof of acceptance of the periodic (holdover) tenancy. The courts customarily rule that a tenant who holds over can do so for a term equal to the term of the original lease, provided the period is for one year or

less. For example, a tenant with a lease for six months would be entitled to a new six-month tenancy. However, if the original lease were for five years, the holdover tenancy could not exceed one year. To avoid this situation, landlords include in their leases language which states that if this type of holdover tenancy should occur that the tenancy is converted to a month-to-month periodic tenancy, which can then be canceled with a 30-day notice.

**In Illinois, a holdover tenancy is for the same term as the estate from period to period. To terminate a periodic estate, either the landlord or the tenant must give proper notice.** Normally, the notice must be given one period in advance.

**The following notices are required by Illinois statute:**

- **Tenancy from year to year** - At least 60 days' written notice is required at any time within the four-month period prior to the last **60 days of the lease period**.
- **Tenancy from month to month** - In any periodic estate having a term of less than year to year but greater than week to week, **30 days' written notice is required**.
- **Tenancy from week to week** - **7 days' written notice is required**.
- **Farm tenancies from year to year**- Parties must give at least four months' written notice to terminate and may do so only at the end of the period. To vacate March 1, farm tenancy notice must be given by November 1.

### **Estate at Will**

**An estate (tenancy) at will gives the tenant the right to possess property with the landlord's consent for an unspecified or uncertain term.** An estate at will is a tenancy of **indefinite duration**; it continues until it is terminated by either party giving proper notice. **An estate at will is automatically terminated by the death of either the landlord or the tenant.** During the existence of a tenancy at will, the tenant has all the rights and obligations of a lessor-lessee relationship, including the duty to pay rent at regular intervals.

### **Estate at Sufferance**

An estate (tenancy) at sufferance arises when a tenant who lawfully possessed real property continues in possession of the premises without the landlord's consent after the rights expire.

This estate can arise:

- when a tenant for years fails to surrender possession at the lease's expiration and continues until the landlord completes the eviction process,
- when a tenant is in breach of the lease.
- A tenancy at sufferance also can occur by operation of law.

A landlord has the option of considering an estate at sufferance (a holdover tenant's action) as being a willful withholding of possession, in which case the landlord is entitled to charge double rent.

## TYPES OF LEASES

### Gross Lease

In a gross lease, the tenant pays a fixed rent, and the landlord pays all taxes, insurance, repairs, utilities, and the like connected with the property (usually called property charges or operating expenses). This is typically the type of rent structure involved in apartment rentals.

### Net Lease

**In a net lease, the tenant pays all or some of the property charges in addition to the base rent.**

The monthly base rental is net income for the landlord after operating costs have been paid. Leases for entire commercial or industrial buildings and the land on which they are located, ground leases, and long-term leases, are usually net leases.

In a **triple-net lease**, or net-net-net lease, the tenant pays all operating and other expenses in addition to rent. These expenses include:

- CAM (common area maintenance and operating expenses) Taxes (Real Estate Taxes)
- Insurance (Building, Liability, and other Insurance Costs)

### Percentage Lease

Either a gross lease or a net lease may be a percentage lease. **The rent is based on a minimum fixed base monthly rental fee plus a percentage of the annual gross income received by the tenant doing business on the leased property.** This type of lease is usually used for retail businesses and restaurants. The percentage charged is negotiable and varies depending on the nature of the business, the location of the property, and general economic conditions.

### Variable Lease

Several types of leases allow for increases in the rental charges during the lease periods. One of the more common is the **graduated lease**, which provides for specified rent increases at set future dates. Another is the **index lease**, which allows rent to be increased or decreased periodically, based on changes in the consumer price index or some other indicator.

### Ground Lease

When a landowner leases unimproved land to a tenant who agrees to erect a building on the land, the lease is usually referred to as a **ground lease**. Ground leases usually involve **separate ownership of the land and buildings**. These leases must be for a long enough term to make the transaction desirable to the tenant investing in the building and often run for **terms of 50 years up to 99 years**. **Ground leases are generally net leases. The lessee must pay rent on the ground as well as real estate taxes, insurance, upkeep, and repairs.**

### Oil and Gas Lease

When an oil company leases land to explore for oil and gas, a special lease agreement must be negotiated. Usually, the **landowner receives a cash payment for executing the lease. If no well is drilled within the period stated in the lease, the lease expires**. However, most oil and gas leases permit the oil company to continue its rights for **another year by paying another flat rental fee. Such rentals may be paid annually until a well is produced. If oil or gas is found, the landowner**

**usually receives a percentage of its value as a royalty.** As long as oil or gas is obtained in significant quantities, the lease continues indefinitely.

### **Lease with Option to Purchase**

**A lease with option to purchase is used when a tenant wants to purchase the property but is unable to do so.** Perhaps the tenant cannot obtain favorable financing or clear title, or the tax consequences of a current purchase would be unfavorable. In this arrangement, the purchase agreement is the primary consideration, and the lease is secondary. **Part of the periodic rent is applied toward the purchase price of the property until that price is reduced to an amount for which the tenant can obtain financing** or purchase the property outright, depending on the terms of the lease-purchase agreement.

### **Sale-and-leaseback**

A sale-and-leaseback is the arrangement whereby the **owners of property sell the property and then lease it back again for an agreed period and rental**. A sale-and-leaseback is often used when extra **capital is needed on a construction project**. The original owners pull out their equity to use on other projects and reduce their taxable income when they pay rent to the new owner. The new owner now has a reliable source of rental income for an extended time. Additionally, **a lease is handled differently than an asset** in relation to a firm's balance sheet, so there may be some accounting advantages.

## **LEASE AGREEMENTS**

### **Requirements of a Valid Lease**

A lease is a form of contract. To be valid, a lease must meet essentially the same requirements as any other contract:

- **Capacity to contract** - The parties must have the legal capacity to contract.
- **Legal objectives** - The objectives of the lease must be legal.
- **Offer and acceptance** - The parties must reach a mutual agreement on all the terms of the contract.
- **Consideration** - The lease must be supported by **valid consideration**. Rent is the normal consideration given for the right to occupy the leased premises. However, the payment of rent is not essential as long as consideration was granted in creating the lease itself.  
**Sometimes, for instance, this consideration is labor performed on the property.**

**The leased premises should be clearly described.** If the lease is for a part of a building, such as an apartment, the space itself or the apartment designation should be described specifically. If supplemental space is to be included, the lease should clearly identify it.

**The elements of a valid lease can be remembered by the acronym CLOAC:**

- Capacity,
- Legal objective,
- Offer and
- Acceptance, and
- Consideration.

## Possession of Premises

The lessor, as the owner of the real estate, is usually bound by the implied covenant of quiet enjoyment. The covenant of quiet enjoyment is a presumed promise by the lessor that the lessee may take possession of the premises. The landlord further guarantees that he will not interfere in the tenant's possession or use of the property.

The lease may allow the landlord to enter the property to perform maintenance, to make repairs, or for other stated purposes. **The tenant's permission is usually required.**

## Use of Premises

**A lessor may restrict a lessee's use of the premises through provisions included in the lease.** *Use restrictions* are particularly common in leases for stores or commercial space. For example, a lease may provide that the leased premises are to be used "only as a real estate office and for no other purpose." In the absence of such clear limitations, a lessee may use the premises for any lawful purpose.

## Term of Lease

The term of a lease is the period for which the lease will run. It should be stated precisely, including the **beginning and ending dates**, together with a statement of the total period of the lease. For instance, a lease might run "for a term of 30 years beginning June 1, 2011 and ending May 31, 2041." **A perpetual lease for an inordinate amount of time or an indefinite term usually will be ruled invalid.**

## Implied Warranty of Habitability

**The Illinois Supreme Court first confirmed the concept of an implied warranty of habitability in residential tenancies in 1972.** Since then, Illinois courts have repeatedly confirmed and amplified the warranty. A landlord must deliver and maintain throughout the duration of the lease any residential leasehold free from defects that would render the use of the dwelling "unsafe or unsanitary" and unfit for human occupancy. Nothing may be present on the premises that could seriously endanger the life, health, or safety of the tenant.

The conditions that violate the implied warranty of habitability vary depending on the state and jurisdiction where the premises are located. Generally, a landlord can be in violation by failing to provide access to:

- drinkable water and hot water,
- heat during cold weather,
- working electricity,
- a smoke detector,
- a working bathroom and toilet,
- removal of rodent or insect infestation, or
- building code violations.

A tenant must give the landlord notice of a defect and reasonable time in which to cure it. As a remedy, the tenant may choose to:

- **move out and terminate the lease** if repairs are not made within a reasonable time - **constructive eviction**,
- **stay and repair the problem himself** and deduct the repair costs from the next month's rent (repair costs cannot exceed one month's rent), or
- **sue for any damages** resulting from the defective condition

## Security Deposit

Most leases require that the tenant provide some form of security deposit to be held by the landlord during the lease term. However, with the paperwork involved in maintaining escrow accounts and interest payment reports, many landlords are opting to charge only a "Move-In Fee". If the tenant defaults on payment of rent or destroys the premises, the **lessor may keep all or part of the deposit to compensate for the loss.**

**Illinois lessees are entitled to receive annual interest on their security deposits. Landlords who receive security deposits on residential leases of units in properties of 25 or more units, on deposits held for more than six months, are required to pay interest from the date of the deposit** at a rate equal to the interest paid on a minimum deposit passbook savings account of the state's largest commercial bank (measured by total assets) with its main banking facilities located in Illinois. Any landlord who is found by a court to have willfully withheld interest on a tenant's security deposit must pay the tenant an amount equal to the security deposit plus the tenant's court costs and attorney's fees. **Note: Chicago security deposit rules and rates for residential landlords differ under the Chicago Residential Landlord and Tenant Ordinance.**

## Improvements

**Neither the landlord nor the tenant is required to make any improvements to the leased property.** The tenant may, however, make improvements with the landlord's permission. **In most residential properties, any alterations become the property of the landlord,** allowance for the wear and tear of normal use.

## Assignment and Subleasing

**When a tenant transfers all of his leasehold interests to another person, the lease has been assigned.** The new tenant is legally obligated for all the promises the original tenant made in the lease.

**On the other hand, when a tenant transfers less than all the leasehold interests by leasing them to a new tenant, the original tenant has subleased (or sublet) the property. The original tenant remains responsible for rent being paid by the new tenant and for any damage done to the rental during the lease term.** The new tenant is responsible only to the original tenant to pay the rent due. **Assignment and subleasing** are only allowed when a lease specifically permits them. In both assignments and subleases, details of the new arrangement should be in writing.

Most leases prohibit a lessee from assigning or subletting without the lessor's consent. This permits the lessor to retain control over the occupancy of the leased premises. As a rule, the lessor must not



unreasonably withhold consent. The **sublessor's (original lessee's) interest in the real estate is known as a *sandwich lease*.**

### Recording a Lease

**Anyone who inspects the property receives actual notice.** For these reasons, it is usually considered **unnecessary to record a lease**. However, most states do allow a lease to be recorded in the county in which the property is located. Some states require that long-term leases be recorded, especially when the lessee intends to **mortgage the leasehold interest, usually for a lease more than 20 years**.

### Non-disturbance Clause

A non-disturbance clause is a mortgage clause stating that the **mortgagee agrees not to terminate the tenancies of lessees who pay their rent should the mortgagee foreclose** on the mortgagor-lessor's building.

### Options

A lease may contain an option that grants the lessee the privilege of **renewing the lease (called a renewal option)**. The lessee must, however, give notice of his intention to exercise the option. Some leases grant the lessee the option to purchase the leased premises (called a **purchase option**).

The lease might also contain a **right of first refusal** clause, allowing the tenant the opportunity to buy the property before the owner accepts an offer from another party.

### DISCHARGE OF LEASES

A lease is discharged when the contract terminates. Termination can occur:

- when all parties have fully performed their obligations under the agreement.
- the parties may agree to cancel the lease.

A tenant who simply **abandons leased property remains liable for the terms of the lease including the rent**. The terms of the lease will usually indicate whether the landlord is obligated to try to re-rent the space. If the landlord intends to sue for unpaid rent, most states require an attempt to mitigate damages by re-renting the premises to limit the amount owed.

The lease does not terminate if the parties die or if the property is sold. There are two exceptions to this general rule:

- A lease from the owner of a *life estate* ends when the tenant's life ends.
- The death of either party terminates a *tenancy at will*.

In all other cases, the heirs of a deceased landlord are bound by the terms of existing leases.

**If leased real estate is sold or otherwise conveyed, the new landlord takes the property subject to the rights of the tenants.** A lease agreement may, however, contain language that permits a new landlord to terminate existing leases. The clause, commonly known as a **sale clause**, **requires that the tenants be given some period of notice before the termination**. Because the new owner has taken title subject to the rights of

the tenants, the sale clause enables the new landlord to claim possession and negotiate new leases under his own terms and conditions.

**A tenancy may also be terminated by operation of law, as in a bankruptcy or condemnation proceeding.**

### **Breach of Lease**

If a tenant defaults on the payment of rent, the landlord has two options:

- He may elect to **serve the tenant with five days' written notice, demanding payment of the delinquent rent within five days after the notice is received.** If the tenant fails to pay the rent, the landlord may terminate the lease automatically and sue for possession without further notice. If the tenant pays the past-due rent, the lease continues in full force.
- **Alternatively (and in cases in which the tenant's breach is other than nonpayment of rent), the landlord may terminate the tenancy by serving the tenant with ten days' written notice, including a demand for possession.** After the ten-day period expires, the landlord may sue for possession without further notice, even if the default is cured.

### **Landlord's Remedies - Actual Eviction**

When a tenant breaches a lease or improperly retains leased premises, the landlord may regain possession through a legal process known as **actual eviction**. The landlord must serve notice on the tenant before commencing the lawsuit.

**When a court issues a judgment for possession to a landlord, the tenant must vacate the property.** If the tenant fails to leave, the landlord can have the judgment **enforced by a court officer**, who forcibly removes the tenant and the tenant's possessions. The landlord then has the right to re-enter and regain possession of the property.

In Illinois, a landlord seeking actual eviction of a tenant **must file an action called a forcible entry and detainer**. It can be used when a tenancy has expired by default, by its terms, by operation of law, or by proper notice. The suit should be filed in the circuit court of the county in which the property is located.

**If the court rules in favor of the landlord, a judgment for possession (and money damages) will be entered, and an order of possession will be issued by the clerk of the court.** The tenant must then leave peaceably, removing all of his property from the premises. Traditionally, however, if a residential tenant personally appears in court and the landlord prevails, the court will delay issuing the order for a reasonable period of time to allow the tenant to find alternative housing.

When a tenant refuses to vacate peaceably after a judgment for possession has been entered, the landlord **must deliver the order to the sheriff, who will forcibly evict the tenant**. The landlord then has the right to re-enter and regain possession of the property.

Until a judgment for possession is issued, the landlord must be careful not to harass the tenant in any manner, such as locking the tenant out of the property, impounding the tenant's possessions, or disconnecting the utilities (such as electricity and natural gas).

**Illinois landlords have no right to self-help; that is, they may not forcibly remove a tenant without following the proper legal procedures.**

### **Tenants' Remedies - Constructive Eviction**

If a landlord breaches any clause of a lease agreement, the tenant has the right to sue and recover damages against the landlord.

If the leased premises become unusable for the purpose stated in the lease, the tenant may have the right to abandon them. This action, called **constructive eviction**, terminates the lease agreement. **The tenant must prove that the premises have become unusable because of the conscious neglect of the landlord.** To claim constructive eviction, the tenant must leave the premises while the conditions that made the premises uninhabitable exist.

## **REGULATION OF THE RENTAL FINDING INDUSTRY**

### **Rental-Finding Services**

A rental-finding service is any business that finds, attempts to find, or offers to find for any person for consideration a unit of rental real estate for a lessee, for a unit of rental real estate not owned or leased by the business.

Any person or business entity that operates a rental-finding service must obtain a real estate license and comply with all provisions of the Illinois Real Estate License Act of 2000. General-circulation newspapers that advertise rental property and listing contracts between owners or lessors of real estate and registrants are exempt from this requirement.

Rental-finding services are required to enter into written contracts with the parties for whom their services are to be performed. The contract must clearly disclose:

- the term of the contract,
- the total amount to be paid for the services,
- the service's policy regarding the refunding of fees paid in advance, and the conditions under which refunds may or may not be paid (printed in a larger typeface than the rest of the contract),
- the type of rental unit, geographic area, and price range the prospective tenant desires,
- a detailed statement of the services to be performed,
- a statement that the contract shall be void, and all fees paid in advance shall be refunded, if the information provided regarding possible rental units available is not current or accurate (that is, if a rental unit is listed that has not been available for more than two days), and
- a disclosure that information regarding possible rental units may be up to two days old.

With regard to any individual rental unit, a prospective tenant must be provided with:

- the name, address, and telephone number of the owner,
- a description of the unit, monthly rent, and security deposit required,
- a description of the utilities available and included in the rent,
- the occupancy date and lease term,

- a statement describing the source of the information,
- and any other information the prospective tenant may reasonably be expected to need.

**A rental-finding service may not list or advertise any rental unit without the express written authority of the unit's owner or agent.**

### **Residential Leasing Agents**

**The Illinois Real Estate License Act of 2000 (Section 5-5 through Section 5-10)** provides for a limited-scope license for individuals who wish to engage solely in activities related to the leasing of residential real property. For instance, the following activities would appropriately fall under this limited license, if the licensee did not engage in any other real estate activities (such as marketing single-family homes):

- Leasing or renting residential real property
- Collecting rent for residential real property
- Attempting, offering, or negotiating to lease, rent, or collect rent for the use of residential real property

**The Act establishes specific qualifications and educational requirements for residential leasing agents, including a written examination.**

### **Referral Fees**

**The Illinois Real Estate License Act of 2000 (Section 5-20)** allows landlords to pay a referral fee to tenants. A resident tenant of a unit who refers a prospective tenant for a unit in the same building or complex may be paid a referral fee if he:

- refers no more than three prospective lessees in any 12-month period,
- limits his activities to referring prospective lessees to the owner (or the owner's agent) and does not show units, discuss lease terms, or otherwise participate in the negotiation of a lease.

Persons under the resident lessee exemption can now receive compensation of no more than \$5,000 or the equivalent of 2 months' rent in any 12-month period.

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## CHAPTER 16: ILLINOIS REAL ESTATE LICENSING LAW

### ILLINOIS REAL ESTATE LAW

The state of Illinois has enacted real estate laws since 1921. The purpose of Illinois Real Estate Licensing Laws is to regulate persons and entities engaged in real estate business for the **protection of the public**. Major changes were made in real estate license law with the **Real Estate License Act of 2000**. We will focus on the review of the Illinois License Law in this chapter as well as other important laws that impact the real estate business.

Federal Laws such as the **Truth-in-Lending Act (TILA)**, **Fair Housing Act**, the **Equal Credit Opportunity Act (ECOA)** and **Real Estate Settlement Procedures Act (RESPA)** regulate certain real estate business practices to ensure fair dealing, ethical conduct, and equal treatment. In addition, required disclosures are intended to inform and protect clients and consumers. State laws such as the **Illinois Residential Real Property Disclosure Act**, the **Illinois Radon Awareness Act**, and the **Illinois Human Rights Act** are discussed earlier in this textbook and should be reviewed by the student.

Local laws and ordinances such as land use, zoning, fair housing, landlord/tenants' rights, and environmental protections should be discussed with your sponsoring broker.

The real estate industry in Illinois is regulated by the **Division of Professional Regulation (DPR)**, a branch of the **Illinois Department of Financial and Professional Regulation (IDFPR)** also known as the Department, which is charged with protecting and improving the lives of Illinois consumers.

**The Department is responsible for administering and enforcing the Illinois Real Estate License Act of 2000.** In addition, the Department administers all licenses for Illinois real estate brokers, managing brokers, residential leasing agents, real estate corporations, partnerships, limited liability companies, real estate branch offices, real estate schools, and real estate instructors.

**The Department promulgates rules for the Act's implementation and enforcement. These are often referred to as "the rules,"** and they supply explanatory detail and guidelines for the Act. The Act, rules, and other significant legislation are available online at [www.ilga.gov](http://www.ilga.gov) (click on Illinois Compiled Statutes, Chapter 225; ILCS 454). These are essential for any real estate licensee to know.

### ADMINISTRATION OF THE ILLINOIS REAL ESTATE LICENSE ACT

#### **Division of Professional Regulation**

The Department, through the Division of Professional Regulation (DPR) has primary authority to administer the Illinois Real Estate License Act of 2000. **It is also empowered to issue rules and regulations that implement and interpret the Act. The rules accompanying the Act are important to a full understanding of the Act's implications and applications.** The Department has the authority to contract with third parties for any services deemed necessary for proper administration of the Act, such as the Applied Measurement Professionals, Inc. (AMP) testing service for Illinois state testing.

**The Department is responsible for administrative activities such as:**

- Conducting license examinations
- Issuing and renewing licenses
- Preparing all forms, including applications, and licenses.
- Collecting fees from applicants and licensees

**The Department has the following additional functions, which may be exercised only on the initiative and approval of the Real Estate Administration and Disciplinary Board:**

- Conducting hearings that may result in the revocation or suspension of licenses or in the refusal to issue or renew licenses
- Imposing penalties for violations of the Act
- Restoring suspended or revoked licenses

**Real Estate Coordinator (Section 25-15)**

A licensed broker is appointed to the position of Real Estate Coordinator by the Secretary of the IDFPR after the recommendations of real estate professionals and organizations are considered. This individual's license is surrendered to the Department during the appointment.

The Real Estate Coordinator's duties include:

- acting as ex officio Chairperson of the Real Estate Administration and Disciplinary Board (without a vote),
- being the direct liaison between the Department, the real estate profession, and real estate organizations and associations,
- preparing and circulating educational and informational material for licensees,
- appointing any committees necessary to assist the Department in carrying out its duties,
- supervising real estate activities, and

**Real Estate Administration and Disciplinary Board (Section 25-10)**

The Real Estate Administration and Disciplinary Board (Board) acts in an advisory capacity to the Real Estate Coordinator regarding **matters involving standards of professional conduct**, discipline, and examination. In addition to its advisory functions, the Board conducts hearings on disciplinary actions against persons accused of violating the Act or the rules. The Board recommends discipline for violations of the Real Estate Licensing Act of 2000 advises the Director on professional conduct, education requirements, and industry trends.

**Composition of the Board**

**The Board is composed of 15 members appointed by the governor, all of whom must have been residents and citizens of Illinois for at least six years before their appointment date. The length of term is for 4 years, not to exceed 10 years.**

- **Twelve members shall have been actively engaged as managing brokers or brokers for at least 10 years prior to the appointment**, of which 2 must possess an active pre-licensing instructor license.
- Three members of the Board shall be public members who represents the consumers' interest.
- None of these members shall be:

- A person who is licensed under this Act or similar Act under another jurisdiction.
  - The spouse or family member of a licensee.
  - A person who has an ownership interest in a real estate brokerage business.
  - A person the Department determines to have any other connection with a real estate Brokerage business or license.
- Chair by statute is the Real Estate Coordinator, of IDFPR - (non-voting member)

**There are four major funds administered through the Department:**

1. Real Estate License Administration Fund (to which license fees and other funds initially go),
2. Real Estate Research and Education Fund (for research and scholarships),
3. Real Estate Recovery Fund (a consumer-oriented fund for compensating consumers harmed by licensees' actions),
4. Real Estate Audit Fund (for conducting audits of special accounts).

**The Real Estate Research and Education Fund (Section 25-25)**

According to Section 25-25 of the act, The Real Estate Research and Education Fund is administered by the Department and held in trust by the Illinois Treasury. On **September 15 of each year**, the treasurer **transfers \$125,000 from the Real Estate License Administration Fund** to the **Real Estate Research and Education Fund**, primarily to be used to **promote real estate research and education at Illinois organizations and institutions of higher learning**. Of this sum, **\$15,000 is set aside for a scholarship program, administered by the Department or a designee of the Department, to support the real estate education of minority real estate professionals**. The scholarship money must go toward courses meant to increase the recipients' knowledge or expertise in the real estate field, including Department-approved broker and managing broker licensing courses, courses necessary to secure the Graduate REALTORS® Institute designation, and courses at accredited Illinois institutions of higher learning.

**OBTAINING AND KEEPING A REAL ESTATE LICENSE**

**Who Needs to Be Licensed? (Section 1-10)**

**It is illegal for anyone to act as a broker, managing broker, sponsoring broker or residential leasing agent without a real estate license issued by the Department.** Any broker who performs any of the following services, either directly or indirectly, whether in or through any media or technology, for another and for compensation must have a real estate license:

- Sells, exchanges, purchases, rents, or leases real estate
- Offers to sell, exchange, purchase, rent, or lease real estate
- Negotiates, offers, attempts, or agrees to negotiate the sale, exchange, purchase, rental, or leasing of real estate
- Lists, offers, attempts, or agrees to list real estate for sale, lease, or exchange
- Buys, sells, offers to buy or sell, or otherwise deals in options on real estate or improvements thereon
- Supervises the collection, offer, attempt, or agreement to collect rent for the use of real estate
- Advertises or represents herself as being engaged in the business of buying, selling, exchanging, renting, or leasing real estate



- Assists or directs in the procuring or referring of leads or prospects intended to result in the sale, exchange, lease, or rental of real estate
- Assists or directs in the negotiation of any transaction intended to result in the sale, exchange, lease, or rental of real estate
- Opens real estate to the public for marketing purposes
- Sells, leases, or offers for sale or lease real estate at auction
- Wholesaling

### **What is Wholesaling?**

When a buyer enters into a purchase agreement with a seller, then the buyer sells the property or assigns the contract to another buyer at a higher purchase price before the first transaction closes, this is wholesaling. When the transaction closes, the first buyer profits on the difference of the transaction without any risk or ownership.

You now must have a real estate license in order to sell any equitable interest the agent has in the transaction. A real estate licensee must disclose to the seller of the property that they will assign the purchase agreement on the property to another buyer for a profit. An individual or entity will need a broker's license or a managing broker's license if engaged in this pattern of business at least twice in a 12-month period." (The full paragraph is in the IDFPR Updates to the Real Estate License Act.

This is not the same as flipping houses. Flipping is when someone buys a property and takes ownership of the property. After doing some repairs or upgrades, the owner places the property back on the market. A real estate license is not required for flipping houses.

### **Unlicensed Agent Act (Section 20-22) Violations**

Any person who is found working or acting as a managing broker, broker, or residential leasing agent or holding himself or herself out as a licensed sponsoring broker, managing broker, broker, or residential leasing agent, without being issued a valid active license is guilty of a class A misdemeanor and, on conviction of a second or subsequent offense, the violator shall be guilty of a class 4 felony. Effective August 9, 2019.

### **License Requirement Exemptions (Section 5-20)**

The requirement for holding a broker, managing broker, sponsoring broker or residential leasing agent license does not apply to the following:

- **Owners or lessors** (whether individuals or business entities) or their regular **employees** who sell, lease, or otherwise deal with **their own property** in the ways described under Article 1 definitions (This applies in the course of the management, the sale, or other disposition of their own [or their employer's] property).
- acting under duly executed and recorded power of attorney to convey real estate from the owner or lessor
- The services rendered by an **attorney at law** in the performance of her **duties as an attorney at law**
- Any person acting as **receiver, trustee in bankruptcy, administrator, executor, or guardian**, or while acting under a court order or under the authority of a will or a testamentary trust

- A **resident apartment manager** working for an owner or working for a broker managing the property, if the apartment is her primary residence and if she is engaged in leasing activities of the managed property
- **State and federal officers** and employees or state government or political subdivision representatives performing official duties
- **Any resident lessee** of a residential dwelling unit who refers for compensation to the owner of the dwelling unit, or to the owner's agent, prospective lessees of dwelling units in the same building or complex as the resident lessee's unit, but only if the resident lessee:
  - refers **no more than 3 prospective lessees in any 12-month period**,
  - receives compensation of **no more than \$5,000** or the equivalent of 2 months' rent, whichever is less, in any 12-month period, and
  - **limits his or her activities to referring prospective lessees** to the owner, or the owner's agent, and **does not show a residential dwelling unit** to a prospective lessee, **discuss terms or conditions of leasing a dwelling unit** with a prospective lessee, or **otherwise participate in the negotiation of the leasing** of a dwelling unit.
- A **hotel operator** who is registered with the Illinois Department of Revenue and pays taxes under the Hotel Operators' Occupation Tax Act and rents a room or rooms in a hotel as defined in the Hotel Operators' Occupation Tax Act for a period of not more than 30 consecutive days and not more than 60 days in a calendar year or a person who participates in an online marketplace enabling persons to rent out all or part of the person's owned residence. Notwithstanding any provisions to the contrary, the Department and its employees shall be exempt from education, course provider, instructor, and course license requirements and fees while acting in an official capacity on behalf of the Department. Courses offered by the Department shall be eligible for continuing education credit.

### Broker's License (Article 5)

A broker is defined as any individual, partnership, limited liability company (LLC), corporation, or registered limited liability partnership other than a residential leasing agent who, for another and for compensation, whether in person or through any media or technology, or with the intention or expectation of receiving compensation, either directly or indirectly, performs any of the services for which a real estate license is required (**Section 1-10**).

### Broker Requirements

Applicants for a broker's license must meet the following requirements, as discussed in Section 5-27:

- Be at least 18 years of age and willing to supply a Social Security number.
  - Be of good moral character
- Have graduated from high school or obtained the equivalent of a high school diploma verified under oath by the applicant
- Provide satisfactory evidence of having completed 75 hours of instruction, 15 hours of which must consist of situational and case studies presented in the classroom or by other interactive delivery method presenting instruction and real time discussion between the instructor and the students.
- Satisfactorily pass a state-sponsored written examination
- 45-hour of post-broker is required before first renewal, it consists of three 15-hour courses covering:

- Applied brokerage principles
- Risk management/discipline
- Transactional issues
- 50 question tests after each section given by the education provider
- Will have, at most, 2.5 years to complete the 45 hours prior to first or second renewal date

### **Managing Broker's License (Article 5)**

As of the 2019 Amendment to the Real Estate Law, all applicants for managing broker licenses in Illinois must:

- be 20 years old or older,
- be of good moral character,
- have been licensed as a **real estate broker** for at least **two of the previous three years**,
- have completed four years of study at a high school or secondary school, approved by the Illinois board of education, or the equivalent to four years of study as determined by an Illinois Board of Education-administered exam and verified by the applicant under oath.
- have completed at least 165 hours of education as follows,
- 120 pre- and post-licensure hours, as required to obtain a broker's license,
- in the **year before the application for managing broker is filed, 45 additional hours on brokerage administration and management**,
- **Of these 45 hours, 15 must consist of classroom instruction or some other means of interactive, real-time instruction and discussion between student and instructor**,
- take and pass a Department-authorized written examination for licensure, and
- submit a valid application for a managing broker license along with the required fees.

Each application for a license (new or renewal) **must include the applicant's social security number or tax identification number**, in addition to the other required information.

**An applicant is permitted to act (subject to IDFPR approval) as designated managing broker after filing her application with the Department and prior to receiving her license but must not continue in this role past the term of 60 days after filing unless her license has been obtained within that period.**

**Should a sponsoring broker's license be revoked or rendered inactive, all licensees under that sponsoring broker will be considered inactive** until such time as the sponsoring broker's license is reinstated or renewed or the licensee changes employment. Expiration dates and renewal periods for each license are set by rule, and **licenses can be renewed within 90 days prior to expiration upon completion of CE and payment of the required fees.**

### **Education exemptions: broker, managing broker**

If an applicant for a broker's and managing broker's license is currently an attorney admitted to the practice of law by the Illinois Supreme Court, she is exempt from the education requirements. **The attorney still must take and pass the state exam.**

### **Continued eligibility: brokers and managing brokers (Section 5-35)**

Approved education for potential brokers and managing brokers is **valid for purposes of licensure for two years after date of satisfactory course completion**. An official uniform transcript is needed for taking the state exam except for persons exempt from the educational requirements.

The broker or managing broker license must be applied for **within one year of passing the state test**. **Failure to do so means retaking the test**. **Failing the state test (either broker or managing broker) four times from the date that the first real estate test was taken requires one to retake the educational coursework**.

### **Corporations, Limited Liability Companies, and Partnerships (Section 5-15)**

A corporation, partnership, or limited liability company (LLC) may receive a broker's license under the following conditions:

- In a *corporation*, **every corporate officer who actively participates in the organization's real estate activities** must hold a **managing broker license**. In addition, every employee of the corporation who acts as a licensee on the corporation's behalf also must hold a license as a real estate broker, managing broker, or residential leasing agent.
- In a partnership, **every general partner must hold a managing broker license**. Every employee of the partnership who acts as a licensee on the partnership's behalf also must hold a license as a real estate broker, managing broker, or residential leasing agent.
- In a *limited liability company* (LLC) or *limited liability partnership* (LLP), **every manager must hold a managing broker's license**. Additionally, every employee of the LLC/LLP who acts as a licensee on the LLC/LLP's behalf also must hold a license as a broker, managing broker, or residential leasing agent.

No corporation, partnership, LLC, or LLP may be licensed to conduct a brokerage business if any individual broker, residential leasing agent, or group of brokers and/or residential leasing agents owns or directly or indirectly controls more than 49 percent of the shares of stock or ownership interest in the business entity.

### **Residential Leasing Agent's License (Article 5)**

The Real Estate License Act of 2000 provides for a residential leasing agent license for persons who wish to engage only in activities limited to the leasing of residential real property in which a license is required. This license allows such activities as "leasing or renting residential real property; attempting, offering, or negotiating to lease or rent residential real property; or supervising the collection, offer, attempt, or agreement to collect rent for the use of residential real property." Licensed brokers and managing brokers do not need a residential leasing agent license for these activities.

A limited residential leasing agent license applicant must meet the following requirements:

- Be at least 18 years of age
- Be of good moral character
- Have a high school diploma or its equivalent
- Successfully complete a 15-hour residential leasing agent pre-license course
- Pass the state's written leasing license examination

**A residential leasing agent must be sponsored by a licensed real estate sponsoring broker.**

### **Period in which to obtain a Residential Leasing Agent License**

A person may engage in residential leasing activities for a period of 120 consecutive days without being licensed, so long as the person is acting under the supervision of a licensed real estate designated managing broker or sponsoring broker and that broker or sponsoring broker has notified the Department that the person is pursuing licensure. **All education, examination, and fee requirements must be met during the 120-day period.** An addition to RELA states that the education must commence by day 60 of the 120 days allowed for licensing (Section 5-5(d)).

## **THE LICENSING EXAMINATION**

### **Requirements to take the State Exam**

Applicants are eligible to take the Residential Leasing Agent, Broker or Managing Broker examination only after they have met the education and age requirements:

- they must also be able to demonstrate that they have met the other requirements set out by the Illinois Real Estate License Act of 2000 and any associated rules.
- The test may be administered only at times and places approved by the Department.
- Each test taker must pay the required fee to the appropriate testing center but will forfeit the fee if failing to appear at the scheduled time, date, and place to take the exam following receipt and acknowledgment of one's application by the Department or testing center.
- Candidates must register with the testing service in advance of the test and pay any fees to reserve a spot at one of many convenient locations throughout Illinois on a day that is convenient to them.
- All candidates must bring to the testing center two pieces of current identification. The first **MUST** be a driver's license with photograph, a passport or military identification with photograph, or an official state identification card with photograph. The second form of identification must display the name and signature of the candidate for signature verification.
- All examinations are given on a computer that displays all the test questions on a monitor and records all the answers. No special knowledge of computers is necessary.
- After completing the test, candidates are immediately informed if they passed or failed.
- Score reports will be emailed to candidates after the exam. A paper copy will no longer be provided after the exam.
- Passing candidates also receive a license application, including directions for applying for a real estate license.
- Passing candidates have one year in which to apply for a license, after which time a new examination will be required.
- Candidates who fail the examination will be told their score and are given diagnostic information in addition to directions on how to apply for a future test.
- Candidates who fail only one portion (either the state or national portion) of the exam are required to retake only the failed portion within 1 year.
- After four failures from the date that the first real estate test was taken, the applicant must successfully repeat all pre-license education before further testing. The fifth attempt to pass the exam is then treated by the Department as if it were a first attempt (**Section 5-35c**).

## THE REAL ESTATE LICENSE

After passing the state exam, applicants will receive a score report sheet. Instructions to apply for the license are on the score report. IDFPR requires this score report sheet and course completion transcript be uploaded to the Online Services Portal during application. **A sponsoring broker is required to approve the application before a license will be issued by the state.**

### **Once a brokerage company has been selected by the person who has passed the State Real Estate Broker Exam:**

- The applicant applies for the license with IDFPR online with their sponsoring broker.
- Their transcript should be uploaded as part of this application process.
- The licensee will receive an email back that they are licensed and then they should print their license within a day or two.
- The license will specify whether the individual is authorized to act as a broker, managing broker, or residential leasing agent.
- IDFPR issues the license online. This license authorizes the bearer to engage in appropriate licensed activities for the current license period.
- Licensees must carry this license or an electronic version of it when engaging in any of the activities for which a license is required by Illinois law. This license must be displayed upon request.

### **What happens to your license when you change or leave firms? (section 5-40)**

#### **Old Broker**

When a licensee quits or the sponsoring broker or a designated managing broker terminates the licensee's employment with the sponsoring broker for any reason, the licensee must obtain her license from the employing broker at whose firm it has been kept.

- The licensee can terminate their license on their own.
- Once a licensee terminates their sponsorship with their sponsoring broker, their license becomes inactive until they find a new sponsoring broker.

#### **New Broker**

If the licensee is simply changing brokers, the new sponsoring broker will immediately complete a change of sponsoring broker form online.

### **Change of Address, Name, or Business Information (Section 5-41)**

It is the licensee's responsibility to promptly notify the Department of any

- changes in their address, telephone number, e-mail address or office location **within 24 hours**,
- business information changes when acquiring or transferring **any interest in a corporation, LLC, partnership, or LLP that is licensed under the Real Estate License Act of 2000.**
- any changes in designated managing brokers, branch managers, or principal officers **within 15 days** after the change.

## Expiration and Renewal

License expiration and renewal dates are established by rule, consistent with the Act; **Licenses may be renewed - by paying required fees and meeting CE requirements—up to 90 days prior to expiration of the license.**

Brokers, managing brokers, and residential leasing agents may renew their expired licenses (provided they pay the necessary fees and meet the continuing education and other requirements) for up to two years following license expiration. Beyond this two-year period, licensees will be required to meet the qualifications for new licenses set out by the Act.

## Nonresidents and License by Reciprocity (Section 5-60)

A managing broker or broker who lives in a state that has a reciprocal licensing agreement with Illinois may be issued an Illinois license (or an Illinois Licensee may be issued a license in the state offering reciprocity) if the following conditions are met. The key feature of Reciprocity is that the Licensee does not have to live in the state offering reciprocity – Illinois licensees do not have to live in the states offering reciprocity and licensees living in other states offering reciprocity do not have to live in Illinois.

- For a reciprocal broker or managing broker's license the broker or managing broker holds a broker or managing broker's license in her home state,
- the licensing standards of that state are substantially equivalent to or greater than the minimum standards required in Illinois,
- the managing broker or broker has been actively practicing as a managing broker or broker for at least two years immediately prior to the application date,
- the managing broker or broker furnishes the Department with an official statement, under seal, from her home state's licensing authority that the managing broker or broker has an active managing broker's or broker's license, is in good standing, and has no complaints pending,
- the managing broker's or broker's home state grants reciprocal privileges to Illinois licensees,
- the managing broker or broker completes a course of education and passes a test on Illinois-specific real estate brokerage laws or the real estate brokerage laws of the state where the Illinois licensee wishes to do business.
- the broker furnishes the Department with a statement under seal of the proper licensing authority of the state in which the broker is licensed showing that the broker has an active broker's license, that the broker is in good standing, and that no complaints are pending against the broker in that state.

Currently, Illinois has reciprocity with the following states under the Real Estate License Act of 2000:

- Nebraska,
- Colorado,
- Connecticut,
- Indiana,
- Iowa,
- Georgia,
- Wisconsin,
- Florida.

**Always check the Department Website for the latest update on reciprocal states.**

Before a managing broker or broker will be issued a license, the applicant must file a designation (Person) in writing to act as her agent in Illinois. **Brokers or managing brokers applying for an Illinois license must furnish the Department with proof of active licensure in their home state.** They also must pay the same license fees that are required of Illinois brokers and managing brokers. Prospective licensees must agree in writing to abide by all provisions of the Act and to submit to the Department's jurisdiction.

However, once acquired, the **reciprocal license allows a new resident who has recently been working under a non-Illinois license to obtain a valid Illinois license without examination.** Licenses previously granted under reciprocal agreements with other states shall remain in force "so long as the Department has a reciprocal agreement with that state."

### **Renewal without Fee (Section 5-50)**

Licensees whose licenses have expired may renew without paying any lapsed renewal or reinstatement fees if the license expired within two years after the termination of the service, training, or education while the licensee was performing any of the following functions:

- On active duty with the U.S. armed services or called into the service or training by the state militia
- Engaged in training or education under supervision of the United States prior to induction into military service
- Serving as the Coordinator of Real Estate in Illinois or as an employee of the Department

### **LICENSE FEES**

Applicants for real estate licenses are subject to appropriate fees in addition to the testing fee paid to AMP when applying for the examination. The Illinois Real Estate License Act of 2000 provides for predetermined licensing fees.

#### **Initial Fees**

- leasing license initial fee is \$75.
- broker initial license fee is \$125.
- managing broker initial fee - \$150
- initial broker's license fee for a partnership, LLC, or corporation is \$125.

Included in the initial license fees are a **Real Estate Recovery Fund fee of \$10** and a **Real Estate Research and Education fee of \$5**. Other licensing fees are indicated in the rules and are set according to actual cost incurred by the Department and may vary.

Returned check penalties and failure to pay (**Section 20-25**) Anyone who delivers a check or other payment to the Department that is returned for insufficient funds must pay a **returned check fine of \$50**, plus the amount originally owed. If the licensee **fails to make full payment of all fees and fines owed within 30 calendar days of the notification that payment is due, the Department will automatically terminate the license or deny the application without a hearing.** The licensee may apply for restoration or issuance of the license and pay all fees and fines due the Department.



## Renewal Fees

- Residential Leasing agent - \$100
- Broker - \$150
- Managing Broker - \$200

## License Renewal Dates

Broker:	April 30, even years
Residential Leasing agent:	July 31, even years
Real estate businesses:	October 31, even years
Managing Broker:	April 30, odd years

## CONTINUING EDUCATION

### Continuing Education Hours — Requirements

- Residential Leasing Agent — 8 hours of continuing education in the core curriculum for each 2-year renewal period
- Broker — 12 hours each 2-year renewal. 4-Hour CORE and 8 Hours of Elective – one hour of elective must include Sexual Harassment Prevention Training
- Managing Broker — 4-Hour CORE and 8 Hours of Elective – one hour of elective must include Sexual Harassment Prevention Training, plus 12 hours of specific broker management continuing education courses.

IDFPR Citations provides an abbreviated, non-disciplinary process for failure to complete Continuing Education in a timely manner. The licensee pay and complete Continuing Education or ask for a hearing. They cannot practice real estate; their license is considered inactive if they did not complete their Continuing Education by the deadline date. All brokers and managing brokers must complete the required courses or equivalent before their licenses may be renewed.

Managing brokers seeking to renew their licenses, beginning with the first renewal period following obtaining a Managing Broker's License, complete a 24-hour Department-approved CE course on broker management during each renewal period and, at the conclusion of the course, take and pass a test developed and administered according to Department specifications.

Managing Broker CE course material shall also include

- sales promotion;
- time management;
- standard real estate company training.

## Instructors

Real estate CE credit may be earned by serving as an approved instructor in an approved course. The amount of credit earned matches the amount of credit given to the course.

## Other Continuing Education Rules:

- Credit hours may be earned for self-study programs

- A broker or managing broker may earn credit for a specific CE course only once during the renewal period.
- No more than twelve hours of courses may be taken in any one day
- Pre-and post-licensing course hours may not be counted toward the CE credit-hour requirements unless specifically permitted by the Illinois Real Estate License Act of 2000.

### **Exempt from the CE requirement**

- Licensees who, during the renewal period, served in the armed services of the United States,
- served as elected state or federal officials,
- served as a full-time employee of the Department,
- Licensees who are licensed attorneys admitted to practice law in Illinois.

No license may be renewed except upon the successful completion of the required courses or their equivalent or upon a waiver of those requirements for good cause shown as determined by the Director of Real Estate upon the recommendation of the Board

If a renewal applicant has earned CE hours in another state, the department may approve the credit at its discretion based upon whether the course is one that would be approved under the Act.

## **YOUR REAL ESTATE BUSINESS AND THE ACT**

### **Place of Business (Section 5-45)**

Any sponsoring broker actively engaged in the real estate business must maintain a definite office or place of business within Illinois. The sponsoring broker must display a visible, conspicuous identification sign outside the office. Inside, the sponsoring broker must conspicuously display the branch office license she sponsors. The sponsoring broker's office or place of business may not be located in any retail or financial establishment unless it is set apart as a clearly separate and distinct area within that establishment.

### **Branch offices**

Any sponsoring broker who wants to establish **branch offices must notify IDFPR for each branch office maintained.** The sponsoring broker names a designated managing broker for each branch office and is responsible for supervising all designated managing brokers. The designated managing broker, who must be a licensed Illinois managing broker, oversees the branch's operations.

The name of the branch office must be the same as the primary real estate office or closely linked to it. The Department must be notified immediately in writing of any change of a primary or branch office location and within 15 days of a change of a designated managing broker for any branch.

### **Exceptions to required place of business**

A broker licensed in Illinois by reciprocity with another state may be **exempt from the requirement of maintaining a definite place of business in Illinois** if the broker:

- maintains an active broker's license in the home state,
- maintains an office in the home state, and

- has filed a written statement with the Department appointing the Secretary to act as the broker's agent for service of process and other legal notices, agreeing to abide by all the provisions of the Illinois Real Estate License Act of 2000, and submitting to the jurisdiction of the Department.

### **Loss of an Office Manager (Section 5-45e)**

In the event a **sponsoring broker dies or a designated managing broker leaves an office unexpectedly, a request may be made to the Department within 15 days of the loss to grant an extension for continued office operations.** The extension may be granted for up to 60 days unless extended by the Department for good cause shown and upon written request by the broker or representative.

### **Employment Agreements (Section 10-20)**

A licensee must have only one sponsoring broker at any given time and may perform real estate activities only for that sponsoring broker. In turn, a sponsoring broker must have a written agreement with any designated managing brokers, brokers, or residential leasing agents (s)he employs. The agreement must describe the significant aspects of their professional relationship, such as supervision, duties, compensation, and grounds for termination, and must address the employment or independent contractor relationship terms. A sponsoring broker must also have a written agreement with any licensed broker acting as an assistant of licensees sponsored by the broker.

### **Agency Relationships (Article 15)**

Once a relationship has been formed between a licensee and a sponsoring broker, the next set of relationships that dominate the real estate business falls under law of agency. Article 15 deals with the licensee's relationships with the public. This article indicates specific standards to be held to in agency relationships. It clearly indicates that **"the law of agency under this Act ...primarily governs the actions of licensees, not common law."** Note that Article 15 of the Real Estate License Act of 2000 is the only section of the Act that has private right of action.

**Section 15.10** sets out the basic relationship with consumers by saying "licensees shall be considered to be representing the consumer they are **working with as a designated (implied) agent for the consumer** unless there is a written agreement between the sponsoring broker and the consumer providing that there is a different relationship.

**Replacing common law, Section 15-15 notes the statutory duties a licensee has toward the client.** The statutory duties are fulfilled by:

- performing the terms of the brokerage agreement between a sponsoring broker and a client,
- promoting the best interest of the client (e.g., timely offer presentation, material facts disclosure, best interests of the client prevail over any self-interest),
- obeying any directions that are not contrary to public policy or law,
- exercising skill and care in performing brokerage services,
- timely accounting for all money and property received in which the client has, may have, or should have had an interest,
- keeping confidential information confidential, and
- complying with the Act and applicable statutes.

The Act also clarifies certain often misunderstood situations that occur when one is an agent. Under the Act the following apply:

- It is considered reasonable to show available properties to various prospects without being viewed as breaching duty to a given client.
- A licensee must provide written disclosure to all clients for whom the licensee is preparing or making contemporaneous offers or contract to purchase or lease the same property and must refer any client that requests a referral to another designated agent.
- It is not considered a conflict for a buyer's agent to show homes wherein the commission is based on the ultimate sales price (in other words, where a higher price creates a higher commission).
- Unless a licensee "knew or should have known the information was false," a licensee is not considered responsible or liable for false information passed on to the client from a customer via the licensee, or vice versa.
- The licensee remains responsible under common law "for negligent or fraudulent misrepresentation of material information."

**Section 15-25** deals with a licensee's treatment of customers. A licensee shall "treat all customers honestly and shall not negligently or knowingly give them false information." Clerical acts are permitted.

**Section 15-40 clearly states that compensation does not determine agency.**

### Dual Agency Disclosure

Informed written consent is required of both buyer and seller for dual agency under **Section 15-45** of the Act. Also, a licensee may not serve as dual agent in any transaction in which (s)he has an ownership interest, whether direct or indirect.

### Designated Agency

The alternative to Dual Agency is highlighted in **Section 15-50**. This allows the sponsoring broker to **appoint or designate one agent for the buyer and one agent for the seller, even within the same firm, without legally being construed as a dual agent. The broker is obligated to protect any confidential information. Because of this, "a designated agent shall disclose to his or her sponsoring broker (or persons specified by the sponsoring broker) confidential information of a client for the purpose of seeking advice or assistance for the benefit of the client in regard to a possible transaction."**

**Article 15 (Agency)** also clearly notes the following:

- Offers of sub-agency through the **multiple listing service (MLS)** are not permitted in Illinois.
- A consumer cannot be held "vicariously liable" for the acts or omissions of a licensee in providing licensed activities for or on behalf of the consumer.
- The Department may further amplify anything in Article 15 by way of promulgating additional rules at any time.
- There is a time limit on legal actions. Legal actions under Article 15 may be forever barred "unless commenced within two years after the person bringing the action knew or should

reasonably have known of such act or omission." In no case may actions be brought after more than five years.

## **Disclosure**

### **What Must Be Disclosed:**

- Material facts of a property
- Known latent physical defects
- Agency relationships
- Designated agency
- Dual agency
- Lack of agency (to a purchasing customer) — No Agency Disclosure Form
- Compensation sources

**Real estate disclosure means an acknowledgment, stated clearly and usually in writing, of certain key facts that the law holds might, if left unknown or if unclear, unfairly influence the course of events.** Failure to disclose is an increasingly serious issue in a consumer-based society and under consumer-driven laws.

### **Article 15, material facts disclosure**

A licensee must disclose to the client "**material facts concerning the transaction of which the licensee has actual knowledge unless that information is confidential information. Material facts do not include physical conditions with little or no adverse effect on the value of the real estate.**"

**A listing agent must disclose to prospective buyer customers "all latent, material, adverse facts pertaining to the physical condition of the property that are actually known by the licensee and that could not be discovered by a reasonably diligent inspection of the property by the customer." A licensee is not to be held liable for false information provided to the customer that the licensee did not actually know was false (15-25a).**

Non-required disclosure items are:

- HIV and AIDS, (Can't Reveal under Federal Law – See Below)
- "any other medical condition",
- the fact that a property was "the site of an act or occurrence that had no effect on the physical condition of the property or its environment or the structures located thereon",
- factual situations for properties other than the "subject of the transaction",
- physical conditions on nearby properties that "do not have a substantial adverse effect on the value of the real estate that is the subject of the transaction."

**It is illegal under federal law to disclose that a property's occupant has or had HIV or AIDS.**

### **Section 15-35, Agency Relationship Disclosure**

**Before a listing agreement, buyer agency agreement, or any other brokerage agreement may be created, a consumer must be told in writing:**

- that No Agency Relationship exists
- that licensee is not acting as the agent of the customer at a time intended to prevent disclosure of confidential information.
- the sponsoring broker's compensation policy insofar as cooperating with brokers who represent other parties in a transaction, if an Agency Agreement is signed
- the name or names of designated agent(s) if an Agency Agreement is signed

### **Section 10-5, Disclosure of Compensation**

The Act holds that clients must be made aware of compensation, source of compensation, and the sponsoring broker's policy on sharing commission with cooperating brokers.

### **Handling Client Funds (Section 20-20)**

**Licensees should immediately provide any earnest money checks to their sponsoring.** The sponsoring broker must "maintain and deposit in a special account, separate and apart from personal and other business accounts, all escrow monies belonging to others entrusted to a licensee while acting as a real estate agent, escrow agent, or temporary custodian of the funds of others."

The Act states that the **sponsoring broker's escrow account is to be noninterest bearing, "unless the character of the deposit is such that payment of interest thereon is otherwise **required by law** or **unless the principals to the transaction specifically require, in writing, that the deposit be placed in an interest-bearing account and who the recipient of the interest is.**"**

Receipts must be made, and a duplicate kept by the sponsoring broker for any escrow monies received

**Earnest money and security deposits must be deposited within one business day of contract or lease acceptance or, if a holiday, the next available business day.** The escrow must be in a federally insured depository.

The Act **does not limit the number of escrow accounts one sponsoring broker may maintain.**

A Sponsoring Broker does not have to have an Escrow Account.

**Commingling** of personal and business funds is prohibited. **Conversion**, or use of the escrow funds for personal or business purposes, is also prohibited.

### **Dispute over Disbursement of Escrow Funds**

If there should be disputes between the parties regarding escrow money, **the sponsoring broker "shall continue to hold the deposit.** The Sponsoring Broker must wait:

- for all parties to signal agreement on the escrow disposition by signing a definite agreement; otherwise, she should not disburse funds
- until such an agreement is reached
- if no agreement can be reached within 6 months, the Sponsoring Broker turns the funds over to the Court, where final decision concerning disbursement of the funds is made, or
- deemed abandoned and transferred to the Office of the State Treasurer to be handled as unclaimed pursuant to the Uniform Disposition of Unclaimed Property Act.

## **Escrow Account Records**

Each sponsoring broker who accepts earnest money shall maintain, in his/her office or place of business, a **bookkeeping system in accordance with sound accounting principles, and** such system shall consist of at least the following escrow records.

### **Journal**

A journal must be maintained for each escrow account. The journal shall show the chronological sequence in which funds are received and disbursed.

#### **For funds received, the journal shall include:**

- the date the funds were received,
- the name of the person on whose behalf the funds are delivered to that sponsoring broker,
- the amount of the funds delivered.

#### **For fund disbursement, the journal shall include:**

- the date,
- the payee,
- the check number,
- the amount disbursed.

**A running balance shall be shown after each entry (receipt or disbursement).**

### **Ledger**

A ledger shall be maintained for each transaction. **The ledger shall show the receipt and the disbursement of funds affecting a single particular transaction such as between buyer and seller, or landlord and tenant, or the respective parties to any other relationship.**

#### **For funds received, the ledger shall include:**

- the names of all parties to a transaction,
- the amount of such funds received by the sponsoring broker,
- the date of such receipt.

#### **For fund disbursement, the ledger shall show:**

- the date,
- the payee,
- the check number,
- the amount disbursed.

The ledger shall segregate one transaction from another transaction. There shall be a separate ledger or separate section of each ledger, as the sponsoring broker shall elect, for each kind of real estate transaction.

**If the ledger is computer-generated, the sponsoring broker must maintain hard copies of:**

- bank deposit slips,

- bank disbursement slips,
- other bank receipts

**These hard copies are to be retained to account for the data on the ledger.**

### **Monthly Reconciliation Statement**

Each sponsoring broker shall reconcile, within ten days after receipt of the monthly bank statement, each escrow account maintained by the sponsoring broker except where there has been no transactional activity during the previous month. Such reconciliation shall include a written worksheet comparing the balances as shown on the bank statement, the journal, and the ledger, respectively, in order to insure agreement between the escrow account and the journal and the ledger entries with respect to such escrow account. **Each reconciliation shall be kept for at least five years from the last day of the month covered by the reconciliation.**

### **Master Escrow Account Log**

Each sponsoring broker shall maintain a master escrow account log identifying all escrow bank account numbers and the name and address of the bank where the escrow accounts are located. The master escrow account log must specifically include all bank account numbers opened for the individual transactions, even if such account numbers fall under another umbrella account number.

**If the Department requests to view or audit escrow records, they must be supplied within 24 hours of the request to the Department personnel.** Escrow records must be **maintained for five years**. The escrow records for the **immediate prior two years shall be maintained in the office location**, and the balance of the records can be maintained at another location.

## **THE LICENSE ACT AND ASSISTANTS**

### **Unlicensed assistants**

These employees can legally perform **only limited tasks (typing, filing, answering phones)**.

### **Licensed broker as assistants**

The actual employment agreement for a licensed broker working as an assistant is made with the sponsoring broker of the firm and can only be compensated by the sponsoring broker.

## **ADVERTISING REGULATIONS (SECTION 10-30)**

**Advertising is expanded to include social media and digital forums.**

**A sponsoring broker must include his/her business name and franchise affiliation in all advertisements.**

The Sponsoring Broker's name shall be at least equal in size or larger than the team names or that of the individual licensee

**Blind ads are prohibited.** Blind ads are defined as advertisements related to the sale or lease of any real estate, other real estate activities, or the hiring of other licensees that:



- Do not indicate the brokerage firm name
- “Blind Advertisement” is expanded to include electronic ads that do not provide a direct link to all the required disclosures
- Do not indicate that the advertiser is a licensee
- Offer only a box number, street address, or telephone number for responses
- **Designated Managing brokers (manage an office) must advertise as Designated Managing Brokers**
- **All other Managing Brokers may advertise as “Managing Brokers”**
- In addition, pursuant to Section 10-40, every brokerage company or entity, other than a sole proprietorship with no other sponsored licensees, must adopt a company or office policy covering certain topics including advertising

**Ads prepared by licensees should at least include:**

- Property for sale,
- licensee name,
- company name (as registered with the Department) and company city/state, and
- the city or area of the advertised property.

**All other ads:**

- licensee name,
- company name (as registered with the Department) and company city/state.

**A licensee must:**

- **NEVER** advertise in only his/her name,
- **ALWAYS** include the firm's name and address,
- **NEVER** advertise another sponsoring broker's listings without written permission,
- **ALWAYS** keep advertisements up-to-date and clear,
- **NEVER** create ads containing "inherently misleading terms," such as: Company, Realty, Real Estate, Agency, Associates, Brokers, Properties, Property.

Licensees must disclose to consumers their **intent to share or sell consumer information that has been collected via the Internet or any other means of electronic communication**. This disclosure must be conspicuous and timely.

**Social Media and Text**

Social media has opened up opportunities for people to communicate with others and grow their business. Social media has changed the way real estate professionals get information out to their clients. Marketing properties through social media allows real estate agents to reach their Sphere of Influence (SOI) and inform clients. Social media also allows agents to market themselves and grow their business.

Social Networking platforms like Facebook, LinkedIn, Instagram, and Twitter, allow agents to reach a wide range of traffic and provide useful information. Posting of events such as showings, new listings, open houses, closings, and any other real estate activities should be done daily.

When texting information to clients, agents must be careful about terms or abbreviations that can be misunderstood or using language that can alienate others.

Agents should be careful about posting/sharing Personally Identifiable Information (PII), for the confidentiality of their clients.

**Licensees advertising via the Internet or other forms of electronic media are forbidden to:**

- employ deceptive or misleading URLs or domain names,
- frame the website of another real estate brokerage or multiple listing service without permission or with the intent or effect of deceiving the consumer, and
- use keywords or other such tools to mislead consumers or deceptively guide or engage Internet traffic.

**Advertising on the Internet**

**Ads prepared for the Internet must adhere to the following:**

- An Internet ad must include proper identification licensee name, company name, company location, and geographic location of property.
- E-correspondence, bulletin boards, or e-commerce discussion groups require licensee name, company name, and company location.
- Links to listing information from other Internet sites are permitted without approval unless the website owner requires approval for links to be added. Any such link must not "mislead or deceive the public as to the ownership of any listing information."
- As with other advertising, internet sites are to be updated periodically and kept current.

**In Internet advertising situations, the rules do not allow:**

- "advertising a property that is subject to an exclusive listing agreement with a sponsoring broker other than the licensee's own without the permission of and identifying that listing sponsoring broker," and
- "failing to remove advertising of a listed property within a reasonable time, given the nature of the advertising, after the earlier of the closing of a sale on the listed property or the expiration or termination of the listing agreement."

**Painting a True Picture**

Licensed real estate agents must present a "true picture" in advertising and representation to the public, including URLs and domain names. The National Association of Realtor® Code of Ethics states:

"Realtors shall be honest and truthful in their real estate communications and shall present a true picture in their advertising, marketing, and other representations.

Realtors shall ensure status as real estate professionals is readily apparent in their advertising, marketing, and other representations and that the recipients of all real estate communications are or have been notified that those communications are from a real estate professional. **Advertising must contain all the information necessary to communicate to the public in an accurate, direct, and readily comprehensible manner.**

### Phone book listings

Licensees **must not place their own names under the heading "Real Estate" in a telephone directory or otherwise advertise their services to the public through any media without also listing the business name of the sponsoring broker with whom they are affiliated.** This rule is consistent throughout all advertising media.

### Selling your own property

Selling or leasing your own property or a property in which you have an interest means you, as a licensee, must use the term "broker-owned" or "agent-owned" in all advertising and on listing sheets.

**If the real estate firm's sign is used in the yard, and the firm's services are being used, then having the "agent-owned" or "broker-owned" notation on the sign itself is not necessary.** However, **all written materials (listing sheets, ads, Internet ads) still must carry the "broker-owned" or "agent-owned" notation.** The Illinois Real Estate License Act of 2000 provides that no matter how one lists an agent-owned property by owner or through a real estate firm **the agent must take care not to confuse the public.**

Finally, it *is* possible and permitted by the Department to list your own personal real estate with a firm other than the one at which you work if you so desire and if your sponsoring broker approves.

### A licensee must:

- ALWAYS disclose "agent-owned"
- Place "agent-owned" on the home sign if FSBO

**If a licensee advertises to personally purchase or lease real estate, disclosure of licensee status is required.**

### Compensation and Business Practice (Article 10)

- **Section 10-5:** A licensee may not receive compensation from anyone other than her sponsoring broker. In turn, sponsoring brokers may compensate only licensees whom they personally sponsor (including licensed brokers working as assistants). The one exception is a former licensee now working for another sponsoring broker but who is due a commission from work completed while still at the first firm.
- Sponsoring brokers may directly compensate other sponsoring brokers (as in a cooperative commission arrangement for the listing broker to pay commission to the firm with the buyer).
- **Section 10-10:** Disclosure of compensation is a significant issue. The Act holds that clients must be made aware of compensation, source of compensation, and the sponsoring broker's policy on sharing commission with cooperating sponsoring brokers.
- If compensation is being issued to an agent from both buyer and seller in one transaction, this must be disclosed. Any third-party compensation must also be disclosed.
- If a licensee refers a client to a service in which the licensee has greater than 1 percent interest (title, legal, mortgage), the interest must be disclosed.
- **Section 10-15:** It is illegal to compensate unlicensed persons or anyone being held in violation of the Act.
- To sue for commission in Illinois, one must be a licensed real estate sponsoring broker.

- **Funds from sellers or buyers always go through the sponsoring broker.** (S)he is the only one who issues compensation to brokers, managing brokers, residential leasing agents, or licensed brokers working as assistants working under him/her.
- **No licensee may pay a referral fee to an unlicensed person who is not a principal to the transaction.** A licensee may not request a referral fee unless *reasonable cause* for payment of the fee exists (a contractual referral fee arrangement).
- **Section 10-15** also states that a licensee "may **offer cash, gifts, prizes, awards, coupons, merchandise, rebates or chances to win a game of chance**, if not prohibited by any other law" to consumers as a legitimate approach to garnering business
- Additionally, it is perfectly legal to share commission compensation with a principal to a given transaction.
- It now is legal for a sponsoring broker to pay a corporation set up by the licensee, rather than the licensee directly, if desired. They cannot sell under the corporate name; they must sell under their own name.
- The law allows formation of an entity to receive licensee compensation from the sponsoring broker where licensee is sole owner; or licensee spouses sponsored by the same sponsoring broker are owners; or licensee and unlicensed spouse are owners of the entity.

## DISCIPLINARY PROVISIONS AND LOSS OF LICENSE

**The Real Estate License Act of 2000 lists specific violations for which licensees may be subject to discipline. The Department is authorized to impose the following disciplinary penalties:**

- Refuse to issue or renew any license
- Suspend or revoke any license
- Censure or reprimand a licensee
- Place a licensee on probation
- Impose a civil penalty of not more than **\$25,000 for any one cause or any combination of causes**

### Causes for Discipline

**The Department may take disciplinary action against a licensee for any one cause or a combination of causes. Specifically, a licensee may be subject to disciplinary action or fines if the licensee:**

- makes a false or fraudulent representation in attempting to obtain or renew a license,
- has been convicted of a felony or of a crime involving dishonesty, fraud, larceny, embezzlement, or obtaining money, property, or credit by false pretenses or by means of a confidence game,
- is unable to practice the profession with reasonable judgment, skill, or safety as a result of a physical illness,
- practices as a licensee in a retail sales establishment from an office, desk, or space that is not separated from the main retail business and in a separate and distinct area,
- has been subjected to disciplinary action by another state, the District of Columbia, a territory, a foreign nation, a government agency, or any other entity authorized to impose discipline if at least one of the grounds for that discipline is the same as or equivalent to a cause for discipline in Illinois,

- has engaged in real estate brokerage without a license or with an expired or inactive license,
- attempts to subvert or cheat on the licensing exam or assists someone else in doing so, or
- advertises in a way that is inaccurate, misleading, or contrary to provisions of the act.

**A licensee also is subject to disciplinary action if found guilty of any of the following activities:**

- Making any false promises to influence, persuade, or induce
- Pursuing a continued and flagrant course of misrepresentation or making false promises through licensee, employees, agents, advertising, or otherwise
- Using any trade name or insignia of membership in any real estate organization of which the licensee is not a member
- Acting for more than one party in a transaction without providing written agency disclosure
- Representing or attempting to represent a broker other than the sponsoring broker
- Failing to account for or remit any monies or documents belonging to others that come into the licensee's possession
- Failing to properly maintain and deposit escrow monies in a separate account
- Failing to make all escrow records maintained in connection with the practice of real estate available during normal business hours and within 24 hours of submitted request
- Failing to keep all records for 5 years – can be kept electronically but must be backed up on a regular basis.
- Failing to furnish, on request, copies of all documents relating to a real estate transaction to all parties executing them
- Failure of the sponsoring broker to provide appropriate licensing documents (license termination information) in a timely way
- Engaging in dishonorable, unethical, or unprofessional conduct of a character likely to deceive, defraud, or harm the public
- Commingling the money or property of others with one's own
- Employing any person on a purely temporary or single-deal basis as a means of evading the law regarding illegal payment of fees to non-licensees
- Permitting the use of one's managing broker's license by another person in order to operate a real estate office
- Displaying a *For Rent* or *For Sale* sign on any property, or advertising in any fashion, without the written consent of the owner
- Failing to provide information requested within 30 days of the request as related to audits or complaints made against the licensee based on the Act
- Utilizing blind advertising
- Offering an improperly constructed guaranteed sales plan, one that does not meet the Act's requirements for such plans
- Intending to promote racial or religious segregation by use of actions or words or behaving or speaking in such a way as to discourage integration
- Violating the Illinois Human Rights Act
- Inducing any individual to break out of an existing contract to enter into a new one, whether a sales contract or a listing contract
- Negotiating directly with the client of another agent
- Acting as an attorney in the same transaction in which one acts as a real estate licensee

- If merchandise or services are advertised for free, any conditions or obligations necessary for receiving the merchandise or services must appear in the same ad or offer
- Disregarding or violating any provisions of the Land Sales Registration Act or the Time-Share Act
- Violating a disciplinary order
- Paying or failing to disclose compensation that violates the Act
- Disregarding or violating any provision of this act or the published rules or any regulations promulgated to enforce the Act
- Failing to provide the minimum services required under an exclusive brokerage agreement
- Violating the terms of a disciplinary order issued by the Department
- Forcing any party to a transaction to compensate the licensee as a requirement for releasing earnest money
- Habitual use or addiction to alcohol, narcotics, stimulants, or any other chemical agent that results in licensee's inability to practice with skill and safety
- Failure to disclose the licensee status on the Multiple Listing Service data form that is accessible to the public if the licensee have any ownership interest in the property

A licensee shall report to the Department, in a manner adopted by rule, any plea of guilty, or nolo contendere to forgery, embezzlement, obtaining money under false pretenses, larceny, extortion, conspiracy to defraud, or any similar offense or offenses or any conviction of a felony involving moral turpitude that occurs during the licensee's term of licensure.

### **Discrimination**

Licensee guilty of discrimination (**Section 20-50**) If there has been a civil or criminal trial in which a licensee has been found to have engaged in illegal discrimination in the course of a licensed activity, the Department must suspend or revoke the licensee's license unless the adjudication is in appeal. Similarly, if an administrative agency finds that a licensee has engaged in illegal discriminatory activities, the Department must take disciplinary action against the licensee unless the administrative order is in appeal.

### **Guaranteed sales plans**

**A "guaranteed sales plan"** means a real estate purchase or sales plan whereby a licensee enters into one or more conditional or unconditional written contracts with a seller, one of which is a brokerage agreement, and wherein the person agrees to purchase the seller's property within a specified period of time, at a specific price, in the event the property is not sold in accordance with the terms of a brokerage agreement to be entered into between the sponsoring broker and the seller. A licensee is subject to disciplinary action if (s)he offers a guaranteed sales plan without complying with the Act's requirements for such agreements.

- A person who offers a guaranteed sales plan to consumers is engaged in licensed activity under this Act and is required to have a license.
- A licensee offering a guaranteed sales plan shall provide the details, including the purchase price, and conditions of the plan, in writing to the party to whom the plan is offered prior to entering into the brokerage agreement.

- A licensee offering a guaranteed sales plan shall provide to the party to whom the plan is offered evidence of sufficient financial resources to satisfy the commitment to purchase undertaken by the broker in the plan.
- A licensee offering a guaranteed sales plan shall undertake to market the property of the seller subject to the plan in the same manner in which the broker would market any other property unless the agreement with the seller provides otherwise.
- The licensee may not purchase seller's property until the period for offering the property for sale has ended according to its terms or is otherwise terminated.
- Any licensee who fails to perform on a guaranteed sales plan in strict accordance with its terms shall be subject to all the penalties provided in this Act for violations thereof and, in addition, shall be subject to a civil fine payable to the party injured by the default in an amount of up to \$25,000 (**Source: P.A. 101-357, eff. 8-9-19**).

### **Unlawful actions by associates if no sponsoring broker knowledge**

**A sponsoring broker will not have his/her license revoked** because of an unlawful act or violation by any broker, managing broker, or residential leasing agent employed by or associated with the sponsoring broker, or by any unlicensed employee, **unless the sponsoring broker had knowledge of the unlawful act or violation**. The sponsoring broker could possibly be held liable for the employee's actions under *vicarious responsibility*.

### **Disciplinary Procedures**

**Any person providing or offering to provide real estate services, or who is licensed or claims to be licensed under the Act, may be investigated by the Department**. At least 30 days before the date of a hearing set for examination of such an issue, and prior to taking any disciplinary action (including but not limited to reprimand, probation, or revocation or suspension of license), the Department will do the following:

- In writing, inform the person under investigation of the charges being brought against her and the location and time of the hearing; this notification may be sent by personal delivery or certified mail to the address given by the individual in her last communication with the Department
- Instruct the accused individual to respond to the charges, under oath and in writing, within 20 days of being informed of the charges and hearing
- Notify the individual that unless (s)he responds as instructed, default will be taken against her and disciplinary action, such as imposition of a fine or license suspension, revocation, or probation, may be instituted.

**At the hearing, the charges will be presented to the Board, and the accused individual and her counsel will be allowed to offer a defense via statements, arguments, testimony, and evidence**. The Board may continue the hearing from time to time. When an individual fails to respond to the notice and the charges are deemed sufficient, the Department may institute disciplinary action without a hearing.

**The Department is required to keep a record of all formal hearing proceedings, at the Department's expense**. According to the same guidelines concerning fees, mileage, and manner

provided for civil cases for state court, the Department is empowered to subpoena materials, such as books, documents, and records, and bring people before it to testify orally or give depositions, or both. All members of the Board as well as the Secretary, the designated hearing officer, may place witnesses under oath in any authorized Department hearing or in other contexts in which the Department is authorized to do so by this act.

**The Department will present the licensee with a copy of the Board's report following the conclusion of the hearing. The licensee may request a rehearing,** via a motion in writing, which indicates the reasons justifying a new hearing. This request must be made within 20 days after the licensee has been served with the Department's report. If the motion for rehearing is denied, the Secretary is empowered to enter an order as recommended by the Board.

If the Secretary determines that emergency action is required to protect the public interest, welfare, or safety, **she may move to suspend the accused individual's license without a hearing first.** However, a hearing must be scheduled for within 30 days of the suspension. The licensee may seek a continuance to postpone the hearing, but in such a case, the suspension will remain in effect.

In any action intended to discipline a license holder or to refuse to issue, restore, or renew a license, the Secretary may appoint an Illinois-licensed attorney to serve in her place as the hearing officer, with complete authority to direct the proceedings. The officer must establish findings pertaining to the allegations, the licensee's conduct, and the law, and present these conclusions to the Board, along with her recommendations. Board members may attend hearings, if they wish, and are required to review the hearing officer's report and then present the board findings to the Secretary and all parties to the hearing. The Secretary is permitted to enter an order that is inconsistent with the board or hearing officer's recommendations if she disagrees with either party.

**Once the order to suspend or revoke a license has been put through, the licensee is required to immediately hand over her license.** If the licensee fails to surrender her license, the Department is empowered to seize it. **If the Board so recommends (in writing), the Department can restore the suspended or revoked license at any time following the event.** The exception to this is any instance in which the Board further investigates the issue, holds a hearing, and decides that restoring the license would not serve the public interest.

The Secretary may order that another hearing be held (before the same examiners or a different set) in the event that she believes that the disciplinary action taken was unjust.

### **Right to Petition Administrative/Judicial Review (Section 20-75)**

All final administrative decisions are subject to judicial review under the provisions of the **Administrative Review Law** and its rules. The accused may request a judicial review by petitioning the circuit court of the county of her residence. If the party is not a resident of Illinois, the venue will be in Sangamon County.



## NONPAYMENT ISSUES WHEN OBTAINING A LICENSE OR RENEWING ONE

### Nonpayment of child support

Specifically highlighted in the Illinois Real Estate License Act of 2000, the Department will **refuse to issue or renew** (or may revoke or suspend) the **licenses of individuals who are more than 30 days delinquent in child support payments.**

### Nonpayment of State Income Tax

Anyone who fails to file a tax return or to pay any tax, penalty, interest, or final assessment required by the Illinois Department of Revenue may have her license withheld or suspended until any such tax requirements are met (**Section 20-35**).

### Nonpayment of Student Loans

If student loans were provided or guaranteed by the Illinois Student Assistance Commission or any governmental agency of the state, and not paid back, the Department will not grant a real estate license to that individual. For an existing licensee, a hearing is made available, after which, if no satisfactory repayment plan has been made, the license may be suspended or revoked.

### Good Moral Character (Section 5-25)

The Board may revoke licenses or refuse to grant licenses to applicants who make **false statements on their licensure applications.** In evaluating an applicant's moral character and deciding whether to grant a license, the Board may take into account facts and events from the applicant's past, including **prior conduct; revocation of her license; conviction for a felony that involved moral turpitude; or a conviction or plea of guilty or nolo contendere in cases involving "forgery, embezzlement, obtaining money under false pretenses, larceny, extortion, or conspiracy to defraud."**

In its consideration of the prior revocation, conduct, or conviction, the Board shall take into account the nature of the conduct, any aggravating or extenuating circumstances, the time elapsed since the revocation, conduct, or conviction, the rehabilitation or restitution performed by the applicant, mitigating factors, and any other factors that the Board deems relevant.

In evaluating past conduct, the Board will consider the particular details of the behavior or violation, how long ago the event(s) took place, whether the applicant has made restitution or been rehabilitated, and other factors as the Board desires.

### Violations (Section 20-22)

Any person who is **found working or acting as a managing broker, broker, or residential leasing agent without being issued a valid existing license is guilty of a Class A misdemeanor** and, **on conviction of a second or subsequent offense, the violator is guilty of a Class 4 felony.**

### Injunctions

In addition to criminal prosecutions, the Department has **the duty and authority to originate an injunction to prevent or stop a violation or to prevent an unlicensed person from acting as a broker, managing broker, or residential leasing agent.**

A violation of the Illinois Real Estate License Act of 2000 is specifically declared to be harmful to the public welfare and a public nuisance. The attorney general of Illinois, a county state's attorney, the Department, and even private citizens may seek an injunction to stop or prevent a violation.

### **Disciplinary Statute of Limitations (Section 20-115)**

No action may be taken by the Department against any person for violation of the terms of this act or its rules **unless the action is commenced within five years after the occurrence of the alleged violation.**

### **Index of Decisions (Section 20-5)**

The Department is **required to maintain an index of all its licensee-related formal decisions.** This includes all refusals to issue, all renewals, or refusals to renew, all revocations or suspensions of licenses, and all probationary and other disciplinary actions. The index is available for public inspection during normal business hours.

**If the licensee wishes to have their license reinstated, the licensee must reimburse the fund all fees plus interest.** The interest rate is established by state statute.

### **THE REAL ESTATE RECOVERY FUND**

**The Real Estate Recovery Fund provides a means of compensation for actual monetary losses (as opposed to losses in market value) suffered by any person as a result of actions by a licensee or a licensee's unlicensed employee:**

- a violation of the Real Estate License Act of 2000, its rules and regulations,
- act of embezzlement of money or property,
- obtaining money or property by:
  - false pretenses,
  - artifice,
  - trickery,
  - forgery,
  - fraud,
  - misrepresentation,
  - deceit,
  - discrimination.

**The procedure for recovery for actual loss by an aggrieved person has been substantially streamlined to allow for actual recovery from the fund if there is a basis for recovery.**

**The fund may pay out a maximum sum as determined by the department to the wronged person, as ordered by the relevant county's circuit court. This amount can include an additional payment for legal costs and attorneys' fees of up to 15 percent of the total amount ordered as recovery for the improper conduct. The maximum fund liability of \$100,000 must be spread equally among all co-owners. Interest is not paid on the recovery amount. **Recovery sums will only be paid out in cases where valid judgments have been made and will not be paid out for violations of the Land Sales Act or the Time-Share Act.****

A claim against the Fund does not need to arise from a loss resulting from intentional misconduct.

The Department will determine by rule the maximum amount an aggrieved person may recover from the Fund, as well as the maximum liability arising out of a licensee's activities. There is no longer a cap on attorney's fees. The Act removes certain barriers to be eligible to recover from the Fund.

### **Collection from the Recovery Fund (Section 20-90)**

When **a lawsuit may result in a claim against the Real Estate Recovery Fund**, the Department must be notified in writing by the aggrieved person at the time the action is commenced against the licensee, specifically, within seven days of filing a suit against the licensee. Failure to notify the Department of the potential liability precludes any recovery from the fund. If the plaintiff is unable to serve the defendant with a summons, the Secretary may be served instead, and this service will be valid and binding on the defendant. Additionally, legal action must have commenced no later than two years after the aggrieved person knew of the acts or omissions that gave rise to possible right of recovery from the fund.

If a claimant recovers a valid judgment in any court against any licensee or unlicensed employee for damages resulting from an act or omission qualifying for coverage under the fund, the Department must receive written notice of the judgment within 30 days. The Department is also entitled to 20 days' written notice of any supplementary proceedings, in order to permit the Department to participate in all efforts to collect on the judgment.

For a claimant to obtain recovery from the fund, all proceedings (including all reviews and appeals) must be completed. **In addition, the claimant must show that she has attempted to recover the judgment amount from the licensee or unlicensed employee's real or personal property or other assets and was either unable to do so or the amount recovered was insufficient to satisfy the judgment.** The names of all licensees and other parties that are in any way responsible for the loss must have been named in the suit. If they were not, it may preclude recovery from the fund. Finally, the claimant must show that the amount of attorney's fees being sought is reasonable.

**When a judgment amount is paid from the Recovery Fund, the Department takes over the rights of the aggrieved party on this issue.** She is required to assign all right, title, and interest in judgment to the Department. By this *subrogation*, any funds recovered on the judgment will be deposited back in the Recovery Fund.

### **Fund Losses Held Against the Licensee (Section 20-90)**

When payment is made from the recovery fund to settle a claim or satisfy a judgment against a licensed broker, managing broker, or unlicensed employee, the license of the offending broker or managing broker is automatically terminated. The broker, or managing broker, may not petition for the restoration of her license until she has made repayment in full to the recovery fund of all awards made due to her actions, plus interest at the statutory annual rate. A discharge in bankruptcy does not relieve a person from the liabilities and penalties provided for in the Illinois Real Estate License Act of 2000. If the licensee wishes to have their license reinstated, the licensee must reimburse the fund all fees plus interest. The interest rate is established by state statute.

**Statute of Limitations (Sections 20-90 and 20-115)**

**A suit that may ultimately result in collection from the fund must be commenced within two years after the date the alleged violation occurred.** The Department must initiate any action it plans to take against an individual licensee within five years of the violation.

**Financing the Recovery Fund (Sections 25-35)**

If at any time during the year the fund slips below \$750,000, the Real Estate License Administration Fund is utilized to upgrade the level to a minimum balance of \$800,000. All recovery fund monies received from applications, renewals, and fines and penalties are deposited into the Real Estate Recovery Fund, and its sums may be invested and reinvested.

**NOTES:**

[illegible]

## CHAPTER 17: GENERAL MATH PROBLEM CATEGORIES

### MEASUREMENT STANDARDS WHICH MUST BE MEMORIZED FOR THE BROKER TEST

#### Linear Measure

12 inches = 1 foot  
3 feet = 1 yard  
5,280 feet = 1 mile

#### Square Measure

144 square inches = 1 square foot  
9 square feet = 1 square yard  
43,560 square feet = 1 acre  
640 acres = 1 square mile (section)  
36 sections = 1 township

#### Cubic Measure

27 cubic feet = 1 cubic yard

#### Tax Valuation X Dollars

Per \$100 AV =  $X/100$  = Tax Rate  
Divide AV by 100 then multiply by  
X Dollars

#### X Mils per \$1 AV

Divide the AV by 1000 then  
multiply by X Mils

#### Formulas for Area

Rectangle	area = length x width
Square	area = side x side
Triangle	area = base x height x 0.5

### Mathematics Percentages

To use a percentage in an arithmetic calculation, change the percentage to its decimal equivalent. The rule for changing a percentage to a decimal is to remove the percent sign and move the decimal point two places to the left (or divide the percentage by 100). Examples of converting a percentage to a decimal are:

98% = 0.98	$1\frac{1}{2}\%$ = 1.5% = 0.015
1.42% = 0.0142	$1\frac{1}{4}\%$ = 1.25% = 0.0125
0.092% = 0.00092	$\frac{3}{4}\%$ = 0.75% = 0.0075

To change a decimal or a fraction to a percentage, simply reverse the procedure. Move the decimal point two places to the right and add the percent sign (or multiply by 100). Some examples of this operation are:

1.00 = 100%	$1 \div 2 = \frac{1}{2} = 0.5 = 50\%$
0.90 = 90%	$3 \div 8 = \frac{3}{8} = 0.375 = 37.5\%$
0.0075 = 0.75%	$2 \div 3 = \frac{2}{3} = 0.667 = 66.7\%$

## COMMISSION PROBLEMS

Problems involving commissions are readily solved by the Formula:

**sales price X rate of commission = total commission**

### SALES

A real estate broker sells a property for \$90,000. Her rate of commission is 7%. What is the amount of commission in dollars?

**Product Missing = multiply**

**Solution: sales price x rate = commission**

**Calculation:**  $\$90,000 \times 0.07 = \$6,300$

**Answer:** \$6,300 commission

A real estate broker earns a commission of \$6,000 in the sale of a residential property. His rate of commission is 6%. What is the selling price?

**Factor Missing = Divide**

**Solution: sales price = commission dollars divided by commission rate**

**Calculation:**  $\$6000 / .06 = \$100,000$

**Answer:** \$100,000 sales price

A real estate broker earns a commission of \$3,000 in the sale of property for \$50,000. What is her rate of commission?

**Factor missing = divide**

**Solution: commission dollars divided by sales price = rate of commission**

**Calculation:**  $\$3,000 / 50,000 = 0.06 = 6\%$

**Answer:** 6% commission rate

### COMMISSION SPLITS

A real estate broker sells a property for \$65,000. The commission on this sale to the real estate firm with whom the broker is associated is 7%. The broker receives 60% of the total commission paid to the real estate firm. What is the firm's share of the commission in dollars?

**Solution Step 1: Selling Price x Commission Rate = Commission Dollars**

**Calculation:**  $\$65,000 \times 7\% = \$4,550$

**Solution Step 2: Total Commission x Firm Share Percentage = Firm Share Dollars**

**Calculation:**  $\$4,550 \times 40\% = \$1,820$

**Answer:** \$1,820

### RENTALS

A real estate salesperson is the property manager for the owner of a local shopping center. The center has five units, each renting for \$24,000 per year. The center has an annual vacancy factor of 4.5%. The commission for rental of the units is 9% of the gross rental income. What is the commission for the year?

**Solution Step 1: Actual Occupancy Rate = 100% - Vacancy Rate**

**Calculation:**  $100\% - 4.5\% = 95.5\% = \text{Actual Occupancy Rate}$

**Solution Step 2: Actual Rent Dollars = Potential Gross Rent X Occupancy Rate**

**Calculation:**  $\$120,000 \times 95.5\% = \$114,600$

**Solution Step 3: Actual Rent x Commission Rate = Commission Dollars**

**Calculation:**  $\$114,600 \times 9\% = \$10,314 = \text{Commission Dollars}$

**Answer:** \$10,314 commission

**ESTIMATING PARTIAL SALES OF LAND**

A subdivision contains 400 lots. If a broker has sold 25% of the lots and his sales staff has sold 50% of the remaining lots, how many lots are still unsold?

**Solution Step 1: Original Number of Lots x Percentage Sold by Broker = Number of Lots Remaining**

**Calculation:**  $400 \times 25\% = 100 \text{ lots}$ .  $400 \text{ Lots minus } 100 \text{ Lots} = 300 \text{ Lots}$

**Solution Step 2: Remaining Lots x % Sold by Sales Staff = Number of lots Sold by Agents**

**Calculation:**  $300 \times 50\% = 150 \text{ Lots}$

**Solution Step 3: Add the number of lots sold**

**Calculation:**  $100 + 150 = 250$

**Solution Step 4: Original Number of Lots less the Number of Lots Sold = Number of Lots Remaining**

**Calculation:**  $400 - 250 = 150$

**Answer:** 150 lots still unsold

**PROFIT/LOSS ON SALE OF REAL ESTATE**

**The formula for profit: investment X percent of profit = dollars in profit**

**The formula for loss: investment X percent of loss = dollars lost**

Mr. Wong buys a house for investment purposes for \$48,000. He sells it six months later for \$54,000 with no expenditures for fix-up or repair. What is Mr. Wong's percentage of profit?

**Solution Step 1: Sales Price less Original investment = Profit Dollars**

**Calculation:**  $\$54,000 - \$48,000 = \$6,000$

**Solution Step 2: Profit Dollars divided by Original Investment Dollars = % Profit**

**Calculation:**  $\$6,000/\$48,000 = 0.125 = 12.5\%$

**Answer:** 12.5% Profit

Ms. Clary purchases some property in 1987 for \$35,000. She makes improvements in 1988 costing her \$15,500. In 1990 she sells the property for \$46,000. What is her percentage of loss?

**Solution Step 1: Purchase Price Plus Improvements = Current Investment**

**Calculation:**  $\$35,000 + \$15,500 = \$50,500$

**Solution Step 2: Investment less Selling Price = Loss**

**Calculation:**  $\$50,500 - \$46,000 = \$4,500 \text{ loss}$

**Solution Step 3: Loss divided by Investment = Percent Loss**

**Calculation:**  $\$4,500/\$50,500 = 8.91\%$

**Answer:** 8.91%

**AREA CALCULATIONS: ACREAGE**

An acre of land has a width of 330 feet. If this acre of land is rectangular in shape, what is its length? (Each acre contains 43,560 square feet).

**Solution Step 1: An Acre has 43,560 square feet**

**Solution Step 2: If Length x Width = Area, then Length = Area/Width**



**Calculation:**  $\text{Length} = 43,560/330 = 132 \text{ feet}$

**Answer:** 132-foot-long lot

If a parcel of land contains 32,670 square feet, what percent of an acre is it?

**Solution Step 1: 43,560 square feet in an Acre**

**Solution Step 2: Part of Area divided by the Total Area = % area**

**Calculation:**  $32,670 \text{ square feet} / 43,560 = 75\% \text{ of an acre}$

**Answer:** 75% of an acre

## SQUARE FOOTAGE

A rectangular lot measures 185 feet by 90 feet. How many square feet does this lot contain?

**Solution: Length x width = Area**

**Calculation:**  $185 \times 90 = 16,650 \text{ square feet}$

**Answer:** 16,650 sq ft area

A room measures 15 feet by 21 feet. We want to install wall-to-wall carpeting and need to calculate the exact amount of carpeting required.

**Solution Step 1: Carpeting sold by square yard, so need answer expressed in square yards**

**Solution Step 2: Calculate Area of Carpet in square feet Length X Width = Area**

**Calculation:**  $15 \times 21 = 315 \text{ square feet.}$

**Solution Step 3 = Convert square feet to square yards — 9 square feet in a square yard (3 x 3)**

**Calculation:**  $315 \text{ square feet} / 9 = 35 \text{ square yards}$

**Answer:** 35 square yards

A new driveway will be installed, 115 feet by 20 feet. The paving cost is \$0.65 per square foot. What will be the minimum cost to pave the new driveway?

**Solution Step 1: Length X Width = Area**

**Calculation:**  $115 \times 20 = 2,300 \text{ square feet}$

**Solution Step 2: Cost of paving driveway - \$0.65 per square foot: Area X Cost/SF = Price**

**Calculation:**  $2,300 \times \$0.65 \text{ per square ft} = \$1,495$

**Answer:** \$1,495

A house measures 28 feet wide by 52 feet long and sells for \$64,000. What is the price per square foot?

**Solution Step 1: Length x Width = Area**

**Calculation:**  $28 \text{ feet} \times 52 \text{ feet} = 1,456 \text{ square feet}$

**Solution Step 2:**  $\$64,000 / 1,456 \text{ square feet} = \$43.96/\text{sq ft}$

**Answer:** \$43.96/sq ft

## COST/SIZE

A triangular lot measures 200 feet along the street and 500 feet in depth on the side perpendicular to the front lot line. If the lot sells for 10 cents per square foot, what is the selling price?

**Solution Step 1: Length X Width divided by 2 = Area of a Triangle**

**Calculation:**  $(200 \text{ feet} \times 500 \text{ feet}) / 2 = 50,000 \text{ square feet}$

**Solution Step 2: Area x Price per sq ft. = Sales Price**

**Calculation:**  $50,000 \text{ square feet} \times \$0.10 = \$5,000 = \text{Sales Price}$

**Answer:** \$5,000 Sales Price

### TAX CALCULATIONS

If the assessed value of the property is \$80,000 and the tax value is 100% of the assessed value, what is the annual tax if the tax rate is \$1.50 per \$100 and the equalization factor is 1.5?

**Solution Step 1: Assessed Value X Equalization Factor = Equalized Assessed Value**

**Calculation:**  $\$80,000 \times 1.5 = \$120,000 = \text{Equalized Assessed Value}$

**Solution Step 2: Equalized Assessed Value times \$1.50/100 = Tax Bill**

**Calculation:**  $\$120,000 \times \$1.50 = \$180,000/100 = \$1,800 \text{ Tax Bill}$

**Answer:** \$1,800 annual taxes

A property sells at the assessed value. The annual real property tax is \$706.56 at a tax rate of \$1.15 per \$100 of tax value, with an equalization factor of 1.2. The property is taxed at 80% of assessed value. What is the selling price?

**Solution Step 1: tax rate/tax value**

**Calculation:**  $\$1.15/\$100 = .0115$

**Solution Step 2: taxes/tax rate = Assessed value**

**Calculation:**  $\$706.56/.0115 = \$61,440$

**Solution Step 3: Assessed value times the equalization factor = Equalized Assessed Value**

**Calculation:**  $\$61,440 \times 1.2 = \$73,728 = \text{Equalized Assessed Value}$

**Solution Step 4: Equalized Assessed value divided by the Assessment Rate = Selling Price**

**Calculation:**  $\$73,728/0.8 = \$92,160 = \text{Selling Price}$

**Answer:** \$92,160 selling price

If the assessed value of property is \$68,000 and the annual tax paid is \$1,105 and the equalization factor is 1.3, what is the tax rate?

**Solution Step 1: Assessed Value x Equalization Factor = Equalized Assessed Value**

**Calculation:**  $\$68,000 \times 1.3 = \$88,400$

**Solution Step 2: Tax Dollars divided by the Equalized Assessed Value x 100 = Tax Rate**

**Calculation:**  $\$1,105/\$88,400 \times 100 = \$1.25 \text{ Per } \$100 \text{ of Tax Value}$

**Answer:** tax rate \$1.25 per \$100 of tax value

If the market value is \$70,000, the tax rate is 120 mills, and the equalization factor is 1.5, and the assessment is 80%, what is the semiannual tax bill? (To get mills, divide by 1000).

**Solution Step 1: Market Value x Assessment rate = Assessed Value**

**Calculation:**  $\$70,000 \times 0.8 = \$56,000$

**Solution Step 2: Assessed Value x Equalization Factor = Equalized Assessed Value**

**Calculation:**  $\$56,000 \times 1.5 = \$84,000$

**Solution Step 3: Equalized Assessed Value divided by 1000 = mills**

**Calculation:**  $\$84,000/1000 = 84 \text{ mills}$

**Solution Step 4: Mills x Tax Rate = Annual Tax Bill**

**Calculation:**  $84 \times 120 = \$10,080 \text{ Annual Tax Bill}$

**Solution Step 5: Annual Tax Bill/2 = Semiannual Tax Bill**

**Calculation:**  $\$10,080/2 = \$5,040 \text{ Semiannual Tax Bill}$

**Answer:** \$5,040 semiannual tax bill

### TRANSFER TAX CALCULATIONS

The conveyance in Illinois is taxed as a result of the Illinois Real Estate Transfer Tax Act. The amount subject to taxation is the sales price minus any assumed mortgage or mortgage taken "subject to."

**State tax:** \$0.50 per \$500 or fraction thereof

**County tax:** \$0.25 per \$500 or fraction thereof

If the total amount of consideration is less than \$100 no tax is required.

A property sold for \$125,000. The purchaser assumed a mortgage on the property in the amount of \$37,450. What is the total amount of transfer tax?

**Solution Step 1: Sales price minus assumed mortgage = taxable amount**

**Calculation:**  $\$125,000 - \$37,450 = \$87,550$

**Solution Step 2: Each 500 and then any Fraction of 500 = Taxable units**

**Calculation:**  $\$87,550/500 = 175$  plus another unit for the \$50 left over = 176 units

**Solution Step 3: Number of Units x \$0.50 = State Tax**

**Calculation:**  $176 \times \$0.50 = \$88.00$

**Solution Step 4: Number of Units x \$0.25 = County Tax**

**Calculation:**  $176 \times \$0.25 = \$44.00$

**Solution Step 5: State Tax plus County Tax = Total Transfer Tax**

**Calculation:**  $\$88.00 + \$44.00 = \$132.00$

**Answer:** \$132 total amount of transfer tax

### PRORATIONS AT CLOSING

#### Proration Rules

- 30-day Standard Month
- 360-day standard Year
- Seller is in possession of the property on the day of closing

In preparing a statement for a closing to be held August 14, a real estate broker determines that the annual real property taxes in the amount of \$360 have not been paid. What will the broker put in the buyer's statement as her entry for real property taxes?

**Solution Step 1: Determine the monthly Tax Amount**

**Calculation:**  $\$360/12 = \$30$  per month

**Solution Step 2: Determine the Daily Tax Amount**

**Calculation:**  $\$30/30 = \$1$  per day

**Solution Step 3: Determine the Total Monthly Taxes Owed**

**Calculation:**  $\$30 \times 7$  (through July) = \$210

**Solution Step 4: Determine the Total Monthly Taxes for the month of closing**

**Calculation:**  $\$1 \times 14 = \$14$

**Solution Step 5: Add the total Tax Amount**

**Calculation:**  $\$210 + \$14 = \$224$

**Answer:** \$224 buyer credit (this is the seller's share of the real property taxes to cover the 7 months and 14 days of the tax year during which he owned the property).

## FINANCIAL CALCULATIONS

### Simple Interest

**Interest calculations use the formula: loan balance X rate of interest = annual interest**

A loan of \$15,000 is repaid in full, one year after the loan is made. If the interest rate on the loan is 12.5%, what amount of interest is owed?

**Solution Step 1: Principle x interest rate = interest dollars**

**Calculation:**  $\$15,000 \times 12.5\% = \$1,875$  Interest Dollars

**Answer:** \$1,875 interest

### Principal and Interest

On October 1, a mortgagor makes a \$300 payment on her mortgage, which is at the rate of 10%. Of the \$300 total payment for principal and interest, the mortgagee allocates \$200 to the payment of interest. What is the principal balance due on the mortgage on the date of the payment?

**Solution Step 1: Monthly Interest x 12 = Annual Interest**

**Calculation:**  $\$200 \times 12 = \$2,400$

**Solution Step 2: Interest \$/Interest Rate = Principal Balance**

**Calculation:**  $\$2,400 / 10\% (0.10) = \$24,000 = \text{Principal Balance}$

**Answer:** \$24,000 mortgage balance on date of payment

If an outstanding mortgage balance is \$16,363.64 on the payment date and the amount of the payment applied to interest is \$150, what is the rate of interest charged on the loan?

**Solution Step 1: Monthly Interest x 12 = Annual Interest**

**Calculation:**  $\$150 \times 12 \text{ mo.} = \$1,800$  annual interest

**Solution Step 2: Interest Dollars/Principal = Rate**

**Calculation:**  $\$1,800 / \$16,363.64 = 11\%$  Interest Rate

**Answer:** 11% interest rate

## DEBT SERVICE

A mortgage loan of \$50,000 at 11% interest requires monthly payments of principal and interest of \$516.10 to fully amortize the loan for a term of 20 years. If the loan is paid over the 20-year term, how much interest does the borrower pay?

**Solution Step 1: Monthly Principal & Interest Payments x 12 = Annual Principal & Interest Payments**

**Calculation:**  $\$516.10 \times 12 = \$6,193.20$

**Solution Step 2: Annual P&I x 20 = Total 20-year principal & interest payments**

**Calculation:**  $\$6,193.20 \times 20 = \$123,864$

**Solution Step 3: Total P&I Pmts less Original Loan = Interest Dollars**

**Calculation:**  $\$123,864 - \$50,000 = \$73,864$

**Answer:** \$73,864 interest paid

## FEES AND POINTS

**The formula for calculating the dollar amount owed in points on a loan is: loan X number of points (percentage) = dollars in points**

A house sells for \$60,000. The buyer obtains an 80% loan. If the bank charges 3 points at closing, how much in points must the buyer pay?

**Solution Step 1: Determine the loan Amount — Selling Price x LTV**

**Calculation:**  $\$60,000 \times 80\% (0.80) = \$48,000$  Loan

**Solution Step 2: Multiply points times Loan = Point Payment**

**Calculation:**  $\$48,000 \times 3\% (0.03) = \$1,440$  Points Payment

**Answer:** \$1,440 points payment

Mr. and Mrs. Schmidt borrow \$64,000. If they pay \$4,480 for points at closing, how many points are charged?

**Solution Step 1: Divide the Point Dollars by the Loan Dollars = Percent of Loan**

**Calculation:**  $\$4,480 / \$64,000 = 0.07 = 7\%$

**Solution Step 2: Each Percentage of the loan equals 1 point**

**Calculation:**  $7\% = 7$  Points

**Answer:** 7 points

Mr. and Mrs. Ortega borrow \$55,000 at 11% interest for 30 years. The bank requires 2 months interest to be placed in escrow and a 1% loan origination fee to be paid at closing. What is the amount of interest to be escrowed? What is the amount charged for the loan origination fee?

**Solution Step 1: Principal x Interest Rate = Annual interest**

**Calculation:**  $\$55,000 \times 11\% (0.11) = \$6,050$  Annual Interest

**Solution Step 2: Annual interest divided by 12 = monthly interest**

**Calculation:**  $\$6,050 / 12 = \$504.17$  Monthly Interest

**Solution Step 3 — 2 x monthly interest = Two Months Interest Escrow**

**Calculation**  $2 \times \$504.17 = \$1,008.33$  Interest Escrow

**Answer 1:** \$1,008.33 interest escrow

**Solution Step 4: Loan times Origination Fee Percentage = Origination Fee Dollars**

**Calculation:**  $\$55,000 \times 1\% (0.01) = \$550.00$  -Loan origination fee

**Answer 2:** \$550.00 loan origination fee

## LOAN-TO-VALUE RATIOS

The appraised value of the home purchased in the problem above is \$68,750. What is the loan-to-value ratio?

**Solution: Loan divided by Selling Price = Loan to Value Ratio**

**Calculation:**  $\$55,000 / \$68,750 = 0.80 = 80\%$  Loan to Value Ratio

**Answer:** 80% loan-to-value ratio

## YIELDS

The percentage of profit is called the yield of the loan. Yields on loans are increased by points paid at closing. Each point charged has the effect of raising the interest rate  $\frac{1}{8}\%$ . The First Bank lends \$100,000 to the borrower and charges 3 points at closing. The interest rate on the loan is 12% for 25 years. What is the bank's effective yield on the loan?

**Solution Step 1: Each point raises Yield by the interest rate - Multiply points by interest rate**

**Calculation:**  $3 \text{ points} \times \frac{1}{8}\% = \frac{3}{8}\%$

**Solution Step 2: Convert fraction to decimals**

**Calculation:**  $\frac{3}{8}\% = 3 \text{ divided by } 8 = 0.375\%$

**Solution Step 3: Add original Interest and Point Equivalent interest to get total interest Yield**

**Calculation:**  $12\% + .375\% = 12.375\%$  Yield

**Answer:** 12.375% Yield

**QUALIFYING FOR A LOAN**

The typical housing debt-to-income ratio for conventional loans is 25-28%. The typical total debt-to-income ratio for conventional loans is 33-36%. The 25-28% means that for the borrower to qualify, PITI (principal, interest, taxes, insurance) must not be more than 25-28% of the borrower's monthly gross income. The 33-36% means that for the borrower to qualify, the total monthly expenses (including housing expense) must not be more than 33-36% of the borrower's monthly gross income.

Mr. and Mrs. Jones have a combined total monthly income of \$2,500. If the lender requires a debt-to-income ratio of 25:33 for housing and total expenses, what is the maximum house payment the Joneses will qualify for? What is the maximum total monthly expenses besides **PM** that will be allowed?

**Solution Step 1 — Calculate 25% of the Gross monthly Income for PITI**

**Calculation:**  $\$2,500 \times 25\% (0.25) = \$625$  PITI

**Solution Step 2 — Calculate 33% of the Gross Monthly Income for Total Debt**

**Calculation:**  $\$2,500 \times 33\% (0.33) = \$825$  — Total Debt

**Solution Step 3 — Subtract the PITI Dollars from the Total Debt Dollars = Other Debt**

**Calculation:**  $\$825 - \$625 = \$200$  for other debt

**Answer:** \$200 for other debt

**APPRAISAL CALCULATIONS**

**Capitalization, income approach, Cap Rate Approach**

Under the income approach, the estimate of value is arrived at by capitalizing the annual net income. The solution to these problems is based on the following formula:

$$\text{Value} \times \text{Capitalization rate} = \text{Net Operating Income}$$

An apartment building produces a net income of \$4,320 per annum. The investor paid \$36,000 for the apartment building. What is the owner's rate of return (cap rate) on the investment?

**Solution: Net Operating Income/Value = Cap Rate**

**Calculation:**  $\$4,320/\$36,000 = 12\%$  Cap Rate

**Answer:** 12% annual rate of return on investment — cap rate

An investor is considering the purchase of an office building for \$125,000. The investor insists upon a 14% return on investment. What must be the amount of the annual net income from this investment to return a profit to the owner at a rate of 14%?

**Solution: Value X Cap Rate = Net Operating Income**

**Calculation:**  $\$125,000 \times 14\% (0.14) = \$17,500$  Net Operating Income

**Answer:** \$17,500 net operating income needed

In appraising a shopping center, the appraiser establishes that the center produces an annual net income of \$97,500. The appraiser determines the capitalization rate to be 13%. What should be the appraiser's estimate of market value for this shopping center?

**Solution - Net Operating Income/Cap Rate =**

Calculation —  $\$97,500 / 13\% (.13) = \$750,000$

**Answer:** \$750,000 market value

#### BASIS

Mr. and Mrs. Swift purchased their home 15 years ago for \$32,500. During their ownership, they made capital improvements totaling \$19,400. They sold the home for \$72,900. What amount of gain did they make on the sale?

**Solution step 1: Purchase Price Plus Improvements = Basis**

**Calculation:**  $\$32,500 + \$19,400 = \$51,900$  Basis

**Solution Step 2: Selling Price less Basis = Gain/Profit**

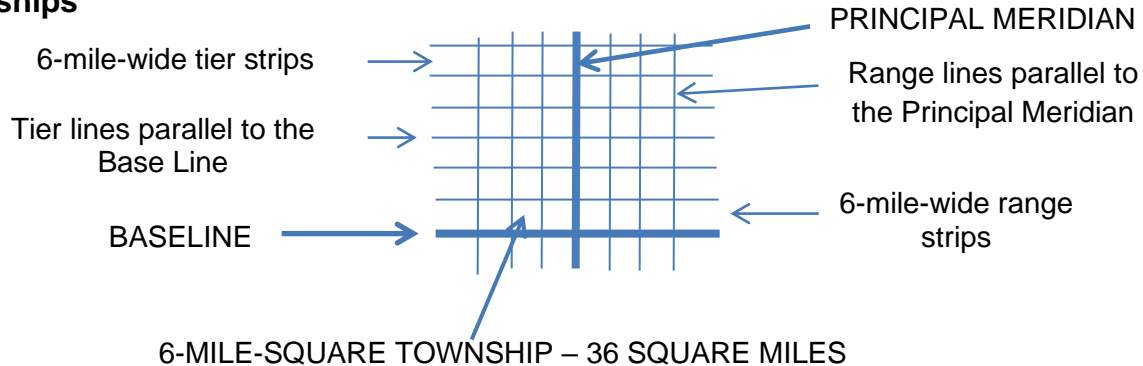
**Calculation:**  $\$72,900$  less  $\$51,900 = \$21,000$  Gain/Profit

**Answer:** \$21,000 gain/Profit

## APPENDIX A: ADDITIONAL MATH PROBLEMS & SOLUTIONS

### Formulas and Equations you need to know:

#### Townships



Mile	5280 Feet
Square Mile	640 Acres
Acre	43,560 Square Feet
Square Yard	9 Square Feet
Cubic Yard	27 Cubic Feet
Square Foot	144 Square Inches
Township	36 Square Miles; 6 Miles Square
Section	1 Square Mile; 640 Acres

#### Tax Valuation X Dollars

Per \$100 AV =  $X/100$  = Tax Rate

#### X Mils per \$1 AV

Divide the AV by 1000 then multiply by X Mils

Divide AV by 100 then multiply by X  
Dollars

#### Area

Square: Side x Side

Rectangle: Length x Width

Triangle: Length x Width divided by 2

Sale Price / Monthly Rent = GRM (of the sold property)

Income ÷ Rate = Value

Income ÷ Value = Rate

Value x Rate = Income

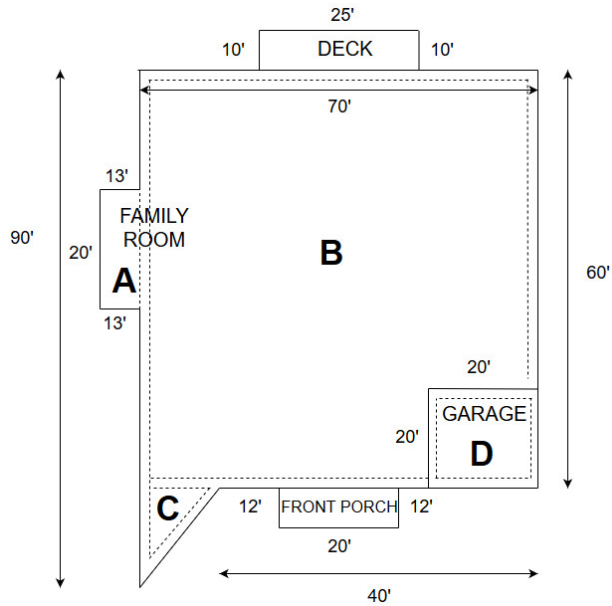


1. An owner divided an acre of land into 6 equal parcels. Each parcel is 50' wide, how deep is each lot?
  - A. 125'
  - B. 145.20'
  - C. 550.50'
  - D. 726'
  
2. An owner of a house wants to carpet 2 rooms. Each room measures 15' x 18'. The cost of the carpeting is \$21 per square yard. How much did the carpeting cost?
  - A. \$810
  - B. \$1,260
  - C. \$2,280
  - D. \$3,780
  
3. A property has a market value of \$380,000. It is being assessed at 20%. The equalization factor is 1.4 and the taxes are \$4 for every \$100. What are the property taxes?
  - A. \$760
  - B. \$4,256
  - C. \$7,600
  - D. \$10,640
  
4. A property has a market value of \$450,000. The property is assessed at 25% the equalization factor is 1.5. What are the monthly taxes if the tax rate is 28 mills?
  - A. \$393.75
  - B. \$472.50
  - C. \$1,687.50
  - D. \$4,725
  
5. A parcel of land is described as the north  $\frac{1}{2}$  of the SE  $\frac{1}{4}$  of the NE  $\frac{1}{4}$  of the SW  $\frac{1}{4}$  of section 23 contains how many acres?
  - A. 5 acres
  - B. 10 acres
  - C. 40 acres
  - D. 160 acres
  
6. A parcel of land is described as the NW  $\frac{1}{4}$  of the NE  $\frac{1}{4}$  and the SW  $\frac{1}{4}$  of section 7, sold for \$16,500 per acre. The commission was 7%. How much did the sponsoring broker earn?
  - A. \$11,550
  - B. \$16,500
  - C. \$115,000
  - D. \$231,000

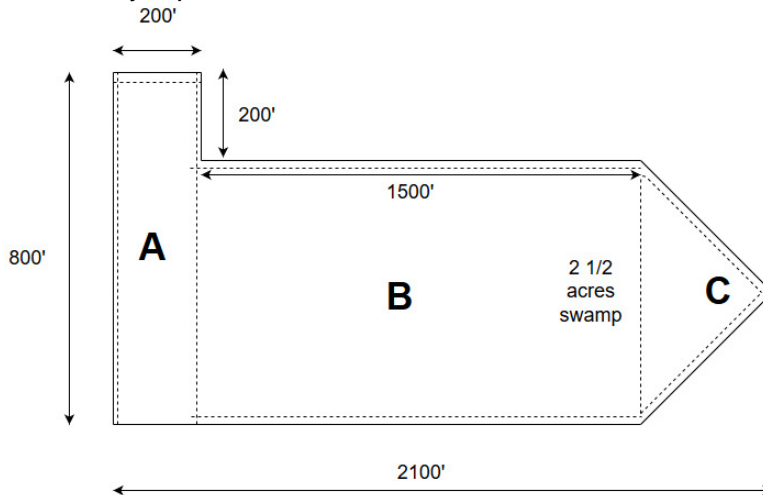
7. A property sold for \$450,000, the commission was 6%. The listing agent will receive 45% of the total commission. The balance will be split 50/50 between the sponsoring broker and the agent who made the sale. How much did the listing agent earn?
- A. \$6,075
  - B. \$12,150
  - C. \$13,500
  - D. \$27,000
8. A property sold for \$240,000. The down payment was 25%. If the buyer and seller agreed to split the discount points of 3 points. How much did the buyer pay in points?
- A. \$2,700
  - B. \$3,600
  - C. \$5,400
  - D. \$7,300
9. A buyer purchased a property for \$360,000 with a down payment of 20%. The lender charged 3 points and 2 loan origination fees. How much did the buyer pay in points?
- A. \$8,640
  - B. \$10,800
  - C. \$14,400
  - D. \$18,000
10. A parcel of land measures 2 miles by 6 miles. How many acres does this parcel contain?
- A. 1,280 acres
  - B. 5,120 acres
  - C. 7,680 acres
  - D. 43,560 acres
11. An owner of a property wants to net \$300,000 from the sale of her property, after paying a 7% commission. What does the property need to sell for?
- A. \$310,500
  - B. \$317,750
  - C. \$321,000
  - D. \$322,580
12. An owner of a house wants to net \$350,000 on the sale of her property, after paying a 6% commission and paying closing cost of \$2,350. What does the house need to sell for in order for the seller to net \$350,000?
- A. \$368,650
  - B. \$371,000
  - C. \$373,350
  - D. \$374,840

13. The rental price of a commercial space is \$1,800 per month plus 3% of the gross sales over \$480,000 per year. Gross sales were \$550,000 for the year. What was the average monthly rent?
- A. \$1,650
  - B. \$1,975
  - C. \$2,100
  - D. \$3,900
14. A property closed on March 20, 2018. The property taxes are \$5,400 per year. The taxes were paid from January 1, 2017 to December 31, 2017. How much does the seller owe the buyer for property taxes?
- A. \$1,200
  - B. \$1,650
  - C. \$2,700
  - D. \$3,900
15. A tenant has a month-to-month tenancy. The rent is \$1,350 per month. On May 1<sup>st</sup>, the landlord went to pick up the rent for the month of May. The tenant said that they are moving and will be out of the apartment by May 22<sup>nd</sup>, the landlord told the tenant that they only have to pay for the days that the tenant occupies the apartment. How much rent did the landlord collect?
- A. \$450
  - B. \$958
  - C. \$990
  - D. \$1,350
16. A homeowner closed on his property on September 9, 2018. The homeowners' insurance is \$1,500 per year. The insurance was paid from January 1, 2018 to December 31, 2018. The new buyer will take over the balance of the homeowners insurance policy for the rest of the year. How much will the buyer owe the seller at the closing.
- A. \$333.56
  - B. \$462.50
  - C. \$1,037.50
  - D. \$1,166.44

17. How many square feet of livable space in the property below: (Hints: The area of a square or rectangle is length times width equals the area. The area of a triangle is  $1/2$  base times the height equals the area).



- A. 4,510 sq. ft.  
B. 4,910 sq. ft.  
C. 5,310 sq. ft.  
D. 5,800 sq. ft.
18. How many square feet of tillable farmland does the owner have in the following land?



- A. 840,000 sq. ft.  
B. 1,071,100 sq. ft.  
C. 1,180,000 sq. ft.  
D. 1,680,000 sq. ft.

19. An owner of a 12-unit apartment building wants to list his property. There are 6 units that rent for \$1,250 per month each and 6 units that rent for \$1,650 per month each. The vacancy factor is 5% of the total rent collected. The expenses total is \$83,450 per year. If the capitalization rate is 6.3%, what is the value of the property.
- A. \$1,141,500
  - B. \$1,823,968
  - C. \$1,976,000
  - D. \$2,080,000
20. An apartment building sold for \$1,400,000. This month income is \$14,800. The yearly expenses are \$81,000. What is the capitalization rate?
- A. 6.9%
  - B. 9.4%
  - C. 12.68%
  - D. 19.5%
21. If the monthly rental income of a house is \$1,800 per month and the Gross Rent Multiplier is 45. What is the value?
- A. \$81,000
  - B. \$116,000
  - C. \$180,000
  - D. \$216,000
22. If a one-mile by one-mile section contains 640 acres, then  $\frac{1}{2}$  mile by  $\frac{1}{2}$  mile contains how many acres?
- A. 160 acres
  - B. 320 acres
  - C. 640 acres
  - D. 43,560 acres
23. An owner wants to net \$360,000 from the sale of his property after paying a commission of 6%. What does the property need to sell for?
- A. \$378,460
  - B. \$380,660
  - C. \$381,600
  - D. \$382,979
24. An owner wants to put up a fence around his property. His rectangular lot measures 125' wide by 290' long. If you allow for a 10' gate, how many feet of fencing will be needed?
- A. 405 feet
  - B. 820 feet
  - C. 36,240 feet
  - D. 36,250 feet

25. An owner wants to net \$425,000 after paying a 5% commission and closing cost of \$3,260. How much does the property need to sell for after paying the commission and closing cost in order for the seller to net \$425,000.
- A. \$446,413
  - B. \$450,000
  - C. \$450,800
  - D. \$456,750

## APPENDIX A – ADDITIONAL MATH PROBLEM SOLUTIONS

1. One acre contains 43,560 square feet  
 $43,560 / 6$  equal lots. Each lot now contains 7,260 square feet.  $7,260 / 50'$  wide equals 145.2' depth of each lot.
2.  $15' \times 18' = 270$  square feet times 2 rooms equals 540 square feet. In a square yard there are 9 square feet ( $3' \times 3' = 9$  sq ft)  
 $540 \text{ sq ft} / 9 = 60$  square yards times \$21 = \$1,260 cost of carpeting.

3.

$$\begin{array}{r} \$380,000 \\ \times \quad 20\% \\ \hline \$76,000 \\ \times \quad 1.4 \\ \hline \$106,400 \\ \times \quad 4 \\ \hline \$425,600 \\ \text{Divided by } 100 = \\ \$4,265 \end{array}$$

4.

$$\begin{array}{r} \$450,000 \\ \times \quad 25\% \\ \hline \$112,500 \\ \times \quad 1.5 \\ \hline \$168,750 \\ \times \quad 0.028 \\ \hline \$4,725 \text{ per year} \\ \text{Divided by } 12 \\ \text{months} = \\ \$393.75/\text{month} \end{array}$$

5. Section 23 = 640 acres  
North  $\frac{1}{2}$  = 320 acres  
SE  $\frac{1}{4}$  = 80 acres  
NE  $\frac{1}{4}$  = 20 acres  
SW  $\frac{1}{4}$  = 5 acres

6. Section 7 = 640 acres

NW  $\frac{1}{4}$  = 160 acres

NE  $\frac{1}{4}$  = 40 acres

AND (add)

SW  $\frac{1}{4}$  = 160 acres

Total = 200 acres

X \$16,500

\$3,300,000

X 7%

\$231,000 commission

7. \$450,000

X 6%

27,000

X 45%

12,150

8. \$ 240,000

X 75%

\$ 180,000 - LOAN AMOUNT

X 3%

\$ 5,400 / 2 = \$2,700

9. \$ 360,000

X 20%

72,000 - DOWN PAYMENT

\$ 360,000

- 72,000

288,000

X 3%

\$ 8,640

10. 2 miles x 6 miles = 12 square miles

12 square miles x 640 acres = 7,680 acres

11. 100% - 7% = 93%

owner's net \$300,000 / 93% = \$322,580

12. 100% - 6% = 94%

\$350,000 – owner's net

+ \$2,350 – closing net

\$352,350 / 94% = \$374,840



13. gross sales           \$550,000  
     minus exclusion    - \$480,000  
                               \$ 70,000 x 3% = \$2100 / 12 months  
                                       = \$175 / month  
                                       + \$1800 base rent  
                                       \$1975 / month total rent

14. taxes           \$5400 / 12 months = \$450 / month

\$450 / 30 days	Jan	\$ 450 / month
= 15 per day	Feb	\$ 450 / month
<u>x 20</u> days	March	<u>\$ 300</u> 20 days
\$300		\$1200 – seller owes buyer

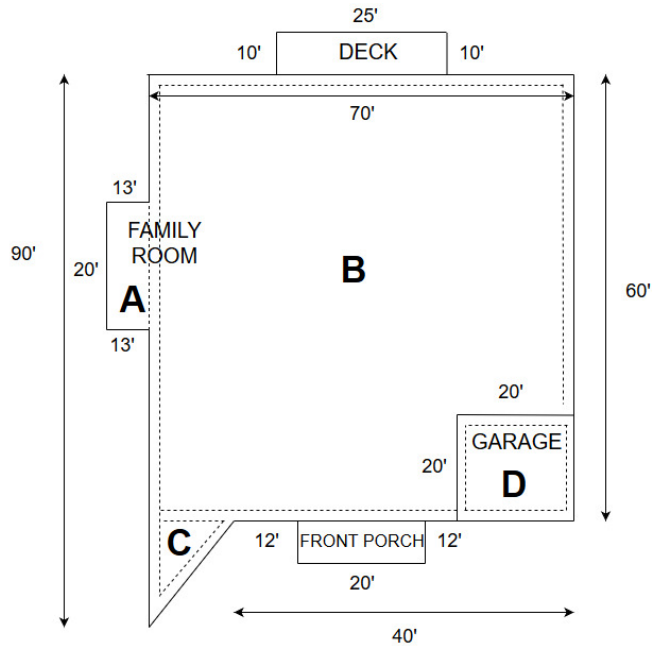
15. \$1350 / month ÷ 30 days = \$ 45 per day  
   22 days  
   \$ 990

16.  
 \$1500 ÷ 12 months = \$ 125 per month           \$ 125  
   x 8 months  
   \$1000

seller used	8 months = \$1,000	\$4.16
	9 days <u>\$37.50</u>	<u>x 9</u> days
	\$1,037.50	\$37.50

seller paid               \$1500  
 seller used            - 1,037.50  
 buyer owes seller \$       \$462.50

17.



To solve this problem, we have to break this house into sections. A person does not live on a deck, front porch, or garage.

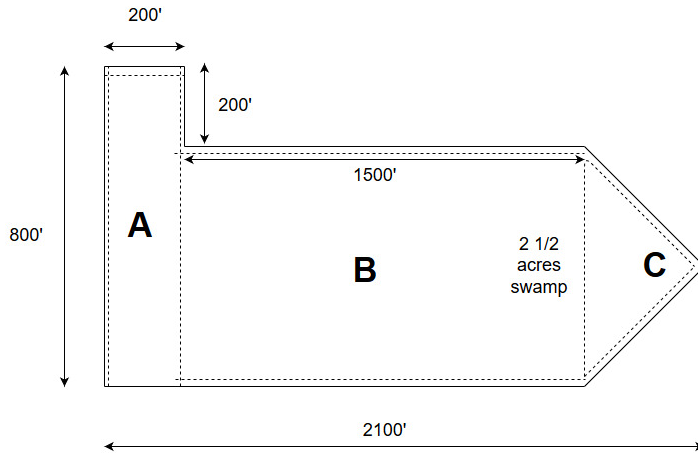
The formula for a square or rectangle is length times width equals the area

the formula for the area of a triangle is  $\frac{1}{2}$  base times the height equals the area

Section A -	13' x 20'	=	260
Section B -	70' x 60'	=	4200
Section C -	$(\frac{1}{2}) 30' \times 30'$		
	15' x 30'	=	450
total square feet			4910
minus garage 20' x 20'			- 400
Total square feet of livable space			4510

18. To solve this problem, we have to break down this farm into sections.

Remember the formulas for a square or rectangle is length times width equals the area. The formula for a triangle is  $\frac{1}{2}$  base times the height equals the area.



Cannot farm a swamp area

This farm has to be broken down into sections

Section A	800' x 200'	=	160,000 sq. ft.
Section B	600' x 1500'	=	900,000 sq. ft.
Section C	$(\frac{1}{2}) 600' \times 400'$		
	300' x 400'	=	+ <u>120,000</u> sq. ft.
	total	=	1,180,000 sq. ft.

Now we must minus the swamp

One acre contains 43,560 sq. ft.

43,560 sq. ft. x 2.5	= 108,900 sq. ft.	- <u>108,900</u>
total tillable land		1,071,100 sq. ft.

19. \$1250	\$1650
<u>X 6 apartments</u>	<u>X 6 apartments</u>
\$7500 PER MONTH	\$9900 PER MONTH
<u>X 12 MONTHS</u>	<u>X 12 MONTHS</u>
\$90,000	\$118,800
\$ 90,000	\$208,800
+ 118,800	<u>5%</u>
\$ 208,800 TOTAL YEARLY INCOME	\$10,440
<u>\$10,440</u> VACANCY	
= \$198,360	
- <u>\$83,450</u> EXPENSES	
\$114,910 NET OR NET OPERATING INCOME	
6.3% CAP RATE	
= \$1,823,968 TOTAL VALUE OF THE PROPERTY	

20. \$ 14,800

X 12 MONTHS

\$177,600 INCOME PER YEAR

- \$81,000 EXPENSES

\$96,600 NET / NET OPERATING INCOME

\$96,600 NOI

\$1,400,000 VALUE

= 6.9% CAPITALIZATION RATE

21. \$ 1800 MONTHLY RENT

X 45 GROSS RENT MULTIPLIER

\$81,000 VALUE

22. 1 MILE X 1 MILE = 640 ACRES

½ MILE X ½ MILE = ¼ sq mile

640 ACRES DIVIDED BY 4 = 160 ACRES

¼ MILE X ¼ MILES = 1/16 sq mile

640 ACRES DIVIDED BY 16 = 40 ACRES

1/8 MILE X 1/8 MILE = 1/64 sq mile

640 ACRES DIVIDED BY 64 = 10 ACRES

23. We need to know what the property needs to sell for at 100%. So, 100% minus the 6% commission leaves 94%. then take \$360,000 and divide by 94% and the answer is \$382,979.

24. A fence will be along the perimeter of the lot, so 125' plus 290' plus 125' plus 290' equals 830' of perimeter, minus 10' gate that means total length of fence needed is 820'.
25. Again, we need to know what the property needs to sell for at 100%. 100% minus 5% commission leaves 95%. now the owner wants to net \$425,000, then we add the closing cost \$3,260 which equals \$428,260, then divide \$428,260 by 95% and the answer is \$450,800. The reason why we add the closing cost to the \$425,000 is since we have already deducted the commission. If we don't add the closing cost to what the seller wants to net, the seller is paying a commission on the closing cost.

**Watch the math video, go over the solutions and practice the math problems. You will have 10 math problems on the state exam similar to these. Keep practicing the math until you are confident in solving the problems.**

## GLOSSARY

- abandonment** The voluntary and permanent cessation of use or enjoyment with no intention to resume or reclaim one's possession or interest. May pertain to an easement or a property.
- abrogation** Tenants cannot sign away their rights in advance of signing the lease.
- abstract of title** A condensed version of the history of title to a particular parcel of real estate as recorded in the county clerk's records; consists of a summary of the original grant and all subsequent conveyances and encumbrances affecting the property.
- abutting** The joining, reaching, or touching of adjoining land. Abutting parcels of land have a common boundary.
- accelerated depreciation** A method of calculating for tax purposes the depreciation of income property at a faster rate than would be achieved using the straight-line method. Note that any depreciation taken in excess of that which would be claimed using the straight-line rate is subject to recapture as ordinary income to the extent of gain resulting from the sale. *See also* straight-line method
- acceleration clause** A provision in a written mortgage, note, bond, or conditional sales contract that, in the event of default, the whole amount of principal and interest may be declared to be due and payable at once.
- accretion** An increase or addition to land by the deposit of sand or soil washed up naturally from a river, lake, or sea.
- accrued depreciation** The actual depreciation that has occurred to a property at any given date; the difference between the cost of replacement new (as of the date of appraisal) and the present appraised value.
- acknowledgment** A declaration made by a person to a notary public, or other public official authorized to take acknowledgments, that an instrument was executed by that person as a free and voluntary act
- Act** From 2020 RELA: "means the Real Estate License Act of 2000."
- actual eviction** The result of legal action originated by a lessor, whereby a defaulted tenant is physically ousted from the rented property pursuant to a court order. *See also* eviction.
- actual notice** Express information or fact; that which is known; actual knowledge.
- adjustable-rate mortgage** A mortgage in which the interest rate changes at predetermined intervals. The mortgage has caps, or a ceiling, that limits the amount it can change at the predetermined intervals.
- administrator** The party appointed by the county court to settle the estate of a deceased person who died without leaving a will.
- ad valorem tax** A tax levied according to value; generally used to refer to real estate tax. Also called the general tax.
- adverse possession** The right of an occupant of land to acquire title against the real owner, where possession has been actual, continuous, hostile, visible, and distinct for the statutory period.
- affidavit** A written statement signed and sworn to before a person authorized to administer an oath.
- Agency** From 2020 RELA: "a relationship in which a broker or licensee, whether directly or through an affiliated licensee, represents a consumer by the consumer's consent, whether express or implied, in a real property transaction."
- agent** One who represents or has the power to act for another person (called the principal). The authorization may be express or implied. A fiduciary relationship is created under the law of agency when a property owner, as the principal, executes a listing agreement or management contract authorizing a licensed real estate broker to be the owner's agent.
- agreement of sale** A written agreement whereby the purchaser agrees to buy certain real estate and the seller agrees to sell, upon terms and conditions set forth in the agreement.
- air lot** A designated airspace over a piece of land. Air lots, like surface property, may be transferred.
- air rights** The right to use the open space above a property, generally allowing the surface to be used for another purpose.
- alienation** The act of transferring property to another. Alienation may be voluntary, such as by gift or sale; or involuntary, such as through eminent domain or adverse possession.

- alienation clause** The clause in a mortgage or deed of trust that states that the balance of the secured debt becomes immediately due and payable at the mortgagee's option if the property is sold by the mortgagor. In effect, this clause prevents the mortgagor from assigning the debt without the mortgagee's approval.
- alluvion** New deposits of soil as the result of accretion.
- amenities** The tangible and intangible features that increase the value or desirability of real estate.
- Americans with Disabilities Act** The ADA is a federal law that became effective in 1992. It is designed to eliminate discrimination against individuals with disabilities by mandating equal access to jobs, public accommodations, public transportation, telecommunications, and government services.
- amortization** The liquidation of a financial burden by installment payments.
- amortized loan** A loan in which the principal, as well as the interest, is payable in monthly or other periodic installments over the term of the loan.
- antitrust laws** The laws designed to preserve the free enterprise of the open marketplace by making illegal certain private conspiracies and combinations formed to minimize competition. Violations of antitrust laws in the real estate business generally involve either price-fixing (brokers conspiring to set fixed compensation rates) or allocation of customers or markets (brokers agreeing to limit their areas of trade or dealing to certain areas or properties).
- appraisal** An estimate of the quantity, quality, or value of something. The process through which conclusions of property value are obtained; also refers to the report setting forth the process of estimation and conclusion of value.
- appraised value** An estimate of a property's present worth.
- appreciation** An increase in the worth or value of a property due to economic or related causes that may prove to be either temporary or permanent; opposite of depreciation.
- appurtenant** Belonging to; incident to; annexed to. For example, a garage is appurtenant to a house. and the common interest in the common elements of a condominium is appurtenant to each apartment. Appurtenances pass with the land when the property is transferred.
- arbitration** A means of settling a controversy between two parties through the medium of an impartial third party whose decision on the controversy (it is agreed) will be final and binding.
- assemblage** The process of merging two or more parcels of real estate to create one parcel.
- assessment** The imposition of a tax, charge, or levy, usually according to established rates.
- assignment** The transfer in writing of rights or interest in a bond, mortgage, lease, or other instrument.
- assumption of mortgage** The transfer of title to property to a grantee wherein he assumes liability for payment of an existing note secured by a mortgage against the property. Should the mortgage be foreclosed and the property sold for a lesser amount than that due, the grantee-purchaser who has assumed and agreed to pay the debt secured by the mortgage is personally liable for the deficiency. Before a seller may be relieved of liability under the existing mortgage, the lender must accept the transfer of liability for payment of the note.
- attachment** The method by which a debtor's property is placed in the custody of the law and held as security pending outcome of a creditor's suit.
- attorney-in-fact** The holder of a power of attorney.
- attorney's opinion of title** An instrument written and signed by the attorney who examines the title, stating the attorney's opinion as to whether a seller may convey good title.
- automatic extension** A clause in a listing agreement that states that the agreement will continue automatically for a certain period of time after its expiration date. In many states, use of this clause is discouraged or prohibited.
- avulsion** The sudden removal of land by natural forces, such as an earthquake.
- balloon payment** The final payment of a mortgage loan that is considerably larger than the required periodic payments because the loan amount was not fully amortized.
- bargain and sale deed** A deed that carries with it no warranties against liens or other encumbrances, but that does imply that the grantor has the right to convey title. Note that the grantor may add warranties to the deed at his or her discretion.

- base line** One of a set of imaginary lines running east and west and crossing a principal meridian at a definite point, used by surveyors for reference in locating and describing land under the rectangular survey system (or government survey method) of property description.
- benchmark** A permanent reference mark or point established for use by surveyors in measuring differences in elevation.
- beneficiary** The person for whom a trust operates, or in whose behalf the income from a trust estate is drawn. Also refers to a lender who lends money on real estate and takes back a note and deed of trust from the borrower.
- bequest** A provision in a will providing for the distribution of personal property.
- bilateral contract** A contract in which each party promises to perform an act in exchange for the other party's promise to perform.
- bill of sale** A written instrument given to pass title to personal property.
- binder** An agreement that may accompany an earnest money deposit for the purchase of real property as evidence of the purchaser's good faith and intent to complete the transaction.
- blanket mortgage** A mortgage covering more than one parcel of real estate, providing for each parcel's partial release from the mortgage lien upon repayment of a definite portion of the debt.
- blind advertisement** From 2020 RELA: "any real estate advertisement that is used by a licensee regarding the sale or lease of real estate, licensed activities, or the hiring of any licensee under this Act that does not include the sponsoring broker's complete business name or, in the case of electronic advertisements, does not provide a direct link to a display with all the required disclosures. The broker's business name in the case of a franchise shall include the franchise affiliation as well as the name of the individual firm."
- blockbusting** The illegal practice of inducing homeowners to sell their properties by making representations regarding the entry, or prospective entry, of minority persons into the neighborhood.
- blue-sky laws** The common name for those state laws that regulate the registration and sale of investment securities.
- Board** From 2020 RELA: "is the Real Estate Administration and Disciplinary Board of the Department as created by Section 25-10 of this Act."
- branch office** A secondary place of business apart from the principal or main office from which real estate business is conducted. A branch office generally must be run by a licensed real estate broker working on behalf of the broker operating the principal office.
- breach of contract** The failure, without legal excuse, of one of the parties to a contract to perform according to the contract.
- broker** From 2020 RELA: "an individual, entity, corporation, foreign or domestic partnership, limited liability company, registered limited liability partnership, or other business entity other than a residential leasing agent who, whether in person or through any media or technology, for another and for compensation, or with the intention or expectation of receiving compensation, either directly or indirectly: (1) Sells, exchanges, purchases, rents, or leases real estate. (2) Offers to sell, exchange, purchase, rent, or lease real estate. (3) Negotiates, offers, attempts, or agrees to negotiate the sale, exchange, purchase, rental, or leasing of real estate. (4) Lists, offers, attempts, or agrees to list real estate for sale, rent, lease, or exchange. (5) Whether for another or themselves, engages in a pattern of business of buying, selling, offering to buy or sell, marketing for sale, exchanging, or otherwise dealing in contracts, including assignable contracts for the purchase or sale of, or options on real estate or improvements thereon. For purposes of this definition, an individual or entity will be found to have engaged in a pattern of business if the individual or entity by itself or with any combination of other individuals or entities, whether as partners or common owners in another entity, has engaged in one or more of these practices on 2 or more occasions in any 12-month period. (6) Supervises the collection, offer, attempt, or agreement to collect rent for the use of real estate. (7) Advertises or represents himself or herself as being engaged in the business of buying, selling, exchanging, renting, or leasing real estate. (8) Assists or directs in procuring or referring of leads or prospects, intended to result in the sale, exchange, lease, or rental of real estate. (9) Assists or directs in the negotiation of any transaction



intended to result in the sale, exchange, lease, or rental of real estate. (10) Opens real estate to the public for marketing purposes. (11) Sells, rents, leases, or offers for sale or lease real estate at auction. (12) Prepares or provides a broker price opinion or comparative market analysis as those terms are defined in this Act, pursuant to the provisions of Section 10-45 of this Act."

**brokerage** The business of buying and selling for another for a commission.

**brokerage agreement** From 2020 RELA: "a written or oral agreement between a sponsoring broker and a consumer for licensed activities to be provided to a consumer in return for compensation or the right to receive compensation from another. Brokerage agreements may constitute either a bilateral or a unilateral agreement between the broker and the broker's client depending upon the content of the brokerage agreement. All exclusive brokerage agreements shall be in writing."

**broker price opinion** From 2020 RELA: "means an estimate or analysis of the probable selling price of a particular interest in real estate, which may provide a varying level of detail about the property's condition, market, and neighborhood and information on comparable sales. The activities of a real estate broker or managing broker engaging in the ordinary course of business as a broker, as defined in this Section, shall not be considered a broker price opinion if no compensation is paid to the broker or managing broker, other than compensation based upon the sale or rental of real estate. A broker price opinion shall not be considered an appraisal within the meaning of the Real Estate Appraiser Licensing Act of 2002, any amendment to that Act, or any successor Act."

**budget loan or budget mortgage** A loan in which the monthly payments made by the borrower cover not only interest and a payment on the principal, but also one-twelfth of such expenses as taxes, insurance, assessments, and similar charges. The monthly payment is called a *PITI payment*.

**buffer zone** A zone or space between two different use districts. An example of a buffer zone would be a park between a residential district and a commercial district.

**building code** An ordinance specifying minimum standards of construction of buildings for the protection of public safety and health.

**building line** A line fixed at a certain distance from the front and/or sides of a lot beyond which no structure can project; a setback line used to ensure a degree of uniformity in the appearance of buildings and unobstructed light, air, and view.

**building restrictions** The limitations on the size or type of property improvements established by zoning acts or by deed or lease restrictions.

**bulk zoning** Bulk zoning controls the density of the development on land to avoid overcrowding.

**bundle of legal rights** The theory that land ownership involves ownership of all legal rights to the land, such as possession, control within the law, and enjoyment, rather than ownership of the land itself.

**buy-down mortgage** A mortgage in which the interest rate is reduced by paying interest in advance. A temporary buy-down is for the initial years of the loan. A permanent buy-down is for the life of the loan.

**capacity of parties** The legal ability of persons to enter into a valid contract. Most persons have full capacity to contract and are said to be competent parties.

**capital gains** A tax on the profits realized from the sale of a capital asset.

**capital improvement** Any improvement that is made to extend the useful life of a property or add to its value.

**capital investment** The initial capital and the long-term expenditures made to establish and maintain a business or investment property.

**capitalization** The process of converting into present value (or obtaining the present worth of) a series of anticipated future periodic installments of net income. In real estate appraising, it usually takes the form of discounting. The formula is expressed as follows:  $\text{Income} = \text{Rate} = \text{Value}$

**capitalization rate** The rate of return a property will produce on the owner's investment.

**cash flow** The net spendable income from an investment, determined by deducting all operating and fixed expenses from the gross income. If expenses exceed income, a negative cash flow is the result.

**casualty insurance** A type of insurance policy that protects a property owner or other person from loss or injury sustained as a result of theft, vandalism, or similar occurrences.

**caveat emptor** A Latin phrase meaning "Let the buyer beware."

**caveat venditor** A Latin phrase meaning "Let the seller beware."

**certificate of eligibility** A certificate given by the federal government to qualified veterans to show their remaining eligibility for a VA-guaranteed loan.

**certificate of occupancy** A certificate of occupancy is issued after the building is inspected to make sure it complies with building codes.

**certificate of reasonable value** A certificate issued by the Veterans Administration certifying the value, as determined by an approved VA appraiser, of property secured by a VA mortgage.

**certificate of reduction** A document issued by the lender to verify the loan balance.

**certificate of sale** The document generally given to a purchaser at a tax foreclosure sale. A certificate of sale does not convey title; generally, it is an instrument certifying that the holder received title to the property after the redemption period had passed and that the holder paid the property taxes for that interim period.

**certificate of title** A statement of opinion on the status of the title to a parcel of real property based on an examination of specified public records.

**cession deed** The type of deed used when land is donated to the government.

**chain of title** The succession of conveyances from some accepted starting point whereby the present holder of real property derives a title.

**chattel** Personal property.

**City Planning Commission** A local governmental organization designed to direct and control the development of land within a municipality.

**client** From 2020 RELA: "a person who is being represented by a licensee."

**cloud on title** A claim or encumbrance that may affect title to land.

**codicil** An addition to a will that alters, explains, adds to, or confirms the will, but does not revoke it.

**coinsurance clause** A clause in insurance policies covering real property that requires the policyholder to maintain fire insurance; coverage is generally equal to at least 80 percent of the property's actual replacement cost.

**collateral** Something of value given or pledged to a lender as security for a debt or obligation.

**commercial property** A classification of real estate that includes income-producing property, such as office buildings, restaurants, shopping centers, hotels, and stores.

**commingled property** That property of a married couple that is so mixed or commingled that it is difficult to determine whether it is separate or community property. Commingled property becomes community property.

**commingling** The illegal act of a real estate broker who mixes the money of other people with that of his or her own; by law, brokers are required to maintain a separate trust account for the funds of other parties held temporarily by the broker.

**commission** The payment made to a broker for services rendered, such as in the sale or purchase of real property; usually a percentage of the selling price of the property.

**common elements** Those parts of a property that are necessary or convenient to the existence, maintenance, and safety of a condominium, or are normally used in common by all of the condominium residents. All condominium owners have an undivided ownership interest in the common elements.

**common law** The body of law based on custom, usage, and court decisions.

**community property** A system of property ownership based on the theory that each spouse has an equal interest in the property acquired by the efforts of either spouse during marriage.

**Community Reinvestment Act** A part of the Housing and Community Development Act passed in 1977. The purpose of the act is to prevent the practice of redlining and disinvestment by lenders in certain areas of a city.

**comparables** The properties listed in an appraisal report that are substantially equivalent to the subject property.

**comparative market analysis** From 2020 RELA: "an analysis or opinion regarding pricing, marketing, or financial aspects relating to a specified interest or interests in real estate that may be based upon an analysis of comparative market data, the expertise of the real estate broker or managing broker, and such other factors

as the broker or managing broker may deem appropriate in developing or preparing such analysis or opinion. The activities of a real estate broker or managing broker engaging in the ordinary course of business as a broker, as defined in this Section, shall not be considered a comparative market analysis if no compensation is paid to the broker or managing broker, other than compensation based upon the sale or rental of real estate. A comparative market analysis shall not be considered an appraisal within the meaning of the Real Estate Appraiser Licensing Act of 2002, any amendment to that Act, or any successor Act."

**compensation** From 2020 RELA: "the valuable consideration given by one person or entity to another person or entity in exchange for the performance of some activity or service. Compensation shall include the transfer of valuable consideration, including without limitation the following: (1) commissions; (2) referral fees; (3) bonuses; (4) prizes; (5) merchandise; (6) finder fees; (7) performance of services; (8) coupons or gift certificates; (9) discounts; (10) rebates; (11) a chance to win a raffle, drawing, lottery, or similar game of chance not prohibited by any other law or statute; (12) retainer fee; or (13) salary."

**competent parties** Those persons who are recognized by law as being able to contract with others; usually those of legal age and sound mind.

**condemnation** A judicial or administrative proceeding to exercise the power of eminent domain, by which a government agency takes private property for public use and compensates the owner.

**conditional-use permit** A permit granted that allows the holder to build a special-purpose property that is inconsistent with zoning in the area. A conditional permit is generally issued to allow buildings for the good of the public, such as hospitals and houses of worship in a residential area.

**condominium** The absolute ownership of an apartment or a unit, generally in a multiunit building, based on a legal description of the airspace that the unit actually occupies, plus an undivided interest in the ownership of the common elements that are owned jointly with the other condominium unit owners. The entire tract of real estate included in a condominium development is called a *parcel*, or *development parcel*. One apartment or space in a condominium building, or a part of a property intended for independent use and having lawful access to a public way is called a *unit*. Ownership of one unit also includes a definite undivided interest in the common elements.

**confidential information** From 2020 RELA: "information obtained by a licensee from a client during the term of a brokerage agreement that (i) was made confidential by the written request or written instruction of the client, (ii) deals with the negotiating position of the client, or (iii) is information the disclosure of which could materially harm the negotiating position of the client, unless at any time: (1) the client permits the disclosure of information given by that client by word or conduct; (2) the disclosure is required by law; or (3) the information becomes public from a source other than the licensee. 'Confidential information' shall not be considered to include material information about the physical condition of the property."

**conformity** The maximum value is achieved when the property is in harmony with its surroundings.

**consideration** Something of value that induces one to enter into a contract. Consideration may be valuable (money or commodity), or good (love and affection).

**constructive eviction** Acts done by the landlord that so materially disturb or impair the tenant's enjoyment of the leased premises that the tenant is effectively forced to move out and terminate the lease without liability for any further rent. Also refers to a purchaser's inability to obtain clear title.

**constructive notice** A notice given to the world by recorded documents. All persons are charged with knowledge of such documents and their contents, whether or not they have actually examined them. Possession of property is also considered constructive notice that the person in possession has an interest in the property.

**consumer** From 2020 RELA: "a person or entity seeking or receiving licensed activities."

**contingency** A provision in a contract that requires completion or that a certain event must occur before the contract becomes binding.

**contract** An agreement entered into by two or more legally competent parties by the terms of which one or more of the parties, for a consideration, undertakes to do or to refrain from doing some legal act or acts. A contract may be either unilateral, where only one party is bound to act, or bilateral, where all parties to the instrument are legally bound to act as prescribed.

- contract for deed** A contract for the sale of real estate wherein the sales price is paid in periodic installments by the purchaser, who is in possession, although title is retained by the seller until final payment. Also called an *installment contract* or a *land contract*.
- contract for exchange of real estate** A contract of sale of real estate in which the consideration is paid wholly or partly in property.
- contract rent** **Rental** income received under the current lease agreement. See *also* market rent. **contribution** The value of any part of the property is measured by its effect on the value of the whole.
- conventional insured mortgage** A mortgage (loan) wherein the borrower has less than a 20 percent down payment. The lender may require that the borrower purchase private mortgage insurance to reduce the lender's risk.
- conventional life estate** A life estate created by the grantor rather than by law.
- conventional mortgage** A mortgage (loan) where real property is used as security for the payment of the debt and the loan is not insured through FHA or guaranteed by VA.
- conventional uninsured mortgage** A mortgage (loan) wherein the borrower has a 20 percent or greater down payment, and the lender accepts the creditworthiness of the borrower and the property as security for the loan.
- conversion** The process of changing from one form of ownership to another, such as apartment use to condo use.
- conveyance** A written instrument that evidences transfer of some interest in real property from one person to another.
- cooperative** A residential multiunit building whose title is held by a trust or corporation, which is owned by and operated for the benefit of persons living within the building, who are the beneficial owners of the trust or stockholders of the corporation, each having a proprietary lease.
- corporation** An entity or organization created by operation of law whose rights of doing business are essentially the same as those of an individual. The entity has continuous existence until dissolved according to legal procedures.
- correction lines** Used in the government survey to compensate for the curvature of the earth.
- cost approach** The process of estimating the value of a special purchase property. The formula is as follows:  
$$\text{Reproduction or replacement cost} - \text{Depreciation} + \text{Land} = \text{Value}$$
- counseling** The business of providing people with expert advice on a subject, based on the counselor's extensive, expert knowledge of the subject.
- counteroffer** A new offer made as a reply to an offer received, having the effect of voiding the original offer, which cannot be accepted thereafter unless revived by the offeror's repeating it.
- covenant** A promise to do or to refrain from doing an act. The covenants found in a general warranty deed are seisin, encumbrances, further assurance, quiet enjoyment, and warranty forever.
- covenant of quiet enjoyment** In a deed, this covenant ensures that the grantee and the grantee's heirs have the right to the property free from interference from the acts or claims of third parties. In a lease, this covenant ensures the tenants' right of possession without interference from the landlord or third parties.
- cul-de-sac** A dead-end street that widens sufficiently at the end to permit an automobile to make a **U**-turn.
- curable depreciation** When the cost of fixing the property does not exceed the value of the property.
- curtesy** A life estate, usually a fractional interest, given by some states to the surviving husband in real estate owned by his deceased wife. Many states have abolished curtesy.
- Customer** From 2020 RELA: "a consumer who is not being represented by the licensee."
- cycle** A recurring sequence of events that regularly follow one another, generally within a fixed interval of time. The cycle of real estate is growth, stability, decline, and restoration.
- datum** A horizontal plane from which heights and depths are measured.
- dba** Doing business as.
- debenture** A note or bond given as evidence of debt and issued without security.
- debt** Something owed to another; an obligation to pay or to return something.

- debt service** A borrower's periodic payment, comprising principal and interest, on the unpaid balance of a mortgage.
- decreasing returns** When adding improvements to the land does not produce a proportional increase in the property value.
- deed** A written instrument that, when executed and delivered, conveys title to, or an interest in, real estate.
- deed in trust** A three-party instrument in which the trustor conveys legal title to the trustee for the benefit of the beneficiary. That trustee has full power to sell, mortgage, and subdivide a parcel of real estate. The beneficiary controls the trustee's use of these powers under the provisions of the trust agreement.
- deed of re-conveyance** The instrument used to re-convey title to a trustor under a deed of trust once the debt has been satisfied.
- deed of trust** An instrument used to create a mortgage lien by which the mortgagor conveys title to a trustee, who holds it as security for the benefit of the note holder (the lender); also called a *trust deed*.
- deed restrictions** The clauses in a deed limiting the future uses of the property. Deed restrictions may impose a vast variety of limitations and conditions, such as limiting the density of buildings, dictating the types of structures that can be erected, and preventing buildings from being used for specific purposes or from being used at all.
- default** The nonperformance of a duty, whether arising under a contract or otherwise; failure to meet an obligation when due.
- defeasance** A provision or condition in a deed or in a separate instrument that, being performed, renders the instrument void.
- defeasible fee estate** An estate in land in which the holder has fee simple title subject to being divested on the happening of a specified condition. Two categories: (1) fee simple determinable or special limitation, and (2) fee simple subject to a condition subsequent.
- deficiency judgment** A personal judgment levied against the mortgagor when a foreclosure sale does not produce sufficient funds to pay the mortgage debt in full.
- delinquent taxes** Those unpaid taxes that are past due.
- delivery** The legal act of transferring ownership. Documents, such as deeds and mortgages, must be delivered and accepted to be valid.
- delivery in escrow** Delivery of a deed to a third person until the performance of some act or condition by one of the parties.
- demand** The willingness of a number of people to accept available goods at a given price; often coupled with supply.
- density zoning** The zoning ordinances that restrict the average maximum number of houses per acre that may be built within a particular area, generally a subdivision.
- department** From 2020 RELA: "means the Department of Financial and Professional Regulation."
- depreciation** In appraisal, a loss of value in property due to all causes, including physical deterioration, functional depreciation, and economic obsolescence. In real estate investment, an expense deduction for tax purposes taken over the period of ownership of income property.
- descent** The hereditary succession of an heir to the property of a relative who dies intestate.
- designated agency** From 2020 RELA: "a contractual relationship between a sponsoring broker and a client under Section 15-50 of this Act in which one or more licensees associated with or employed by the broker are designated as agent of the client."
- designated agent** From 2020 RELA: "a sponsored licensee named by a sponsoring broker as the legal agent of a client, as provided for in Section 15-50 of this Act."
- designated managing broker** From 2020 RELA: "a managing broker who has supervisory responsibilities for licensees in one or, in the case of a multi-office company, more than one office and who has been appointed as such by the sponsoring broker registered with the Department."
- determinable fee estate** A defeasible fee estate in which the property automatically reverts to the grantor upon the occurrence of a specified event or condition. Also known as *special limitation*.

- devise** A transfer of real estate by will or last testament. The donor is the devisor and the recipient is the devisee.
- diminishing returns** The principle of diminishing returns applies when a given parcel of land reaches its maximum percentage return on investment, and further expenditures for improving the property yield a decreasing return.
- dual agency** From 2020 RELA: " an agency relationship in which a licensee is representing both buyer and seller or both landlord and tenant in the same transaction. When the agency relationship is a designated agency, the question of whether there is a dual agency shall be determined by the agency relationships of the designated agent of the parties and not of the sponsoring broker."
- economic obsolescence** The impairment of desirability or useful life arising from factors external to the property, such as economic forces or environmental changes that affect supply and demand relationships in the market. Loss in the use and value of a property arising from the factors of economic obsolescence is to be distinguished from loss in value from physical deterioration and functional obsolescence, both of which are inherent in the property. Also referred to as *locational obsolescence* or *environmental obsolescence*.
- emblements** Those growing crops produced annually through the tenant's own care and labor, and that can be taken away after the tenancy is ended. Emblements are regarded as personal property even prior to harvest, so if the landlord terminates the lease, the tenant may still reenter the land and remove such crops. If the tenant terminates the tenancy voluntarily, however, the tenant is not generally entitled to the emblements.
- eminent domain** The right of a government or municipal quasi-public body to acquire property for public use through a court action called *condemnation*, in which the court determines that the use is a public use and determines the price or compensation to be paid to the owner.
- employee** From 2020 RELA: "or other derivative of the word "employee", when used to refer to, describe, or delineate the relationship between a sponsoring broker and a managing broker, broker, or a residential leasing agent, shall be construed to include an independent contractor relationship, provided that a written agreement exists that clearly establishes and states the relationship."
- employee status** One who works as a direct employee of an employer. The employer is obligated to withhold income taxes and Social Security taxes from the compensation of employees. See *also* independent contractor.
- employment contract** A document evidencing formal employment between employer and employee or between principal and agent. In the real estate business, this generally takes the form of a listing agreement or management agreement.
- encroachment** A fixture, or structure, such as a wall or fence that invades a portion of a property belonging to another.
- Encumbrance** Any lien, such as a mortgage, tax, or judgment lien, an easement, a restriction on the use of the land, or an outstanding dower right that may diminish the value of the property.
- Equal Credit Opportunity Act** The ECOA is a federal act that prohibits discrimination by lenders on the basis of race, color, religion, sex, national origin, age, or marital status in any aspect of a credit transaction.
- equalization** The raising or lowering of assessed values for tax purposes in a particular county or taxing district to make them equal to assessments in other counties or districts.
- equitable lien** A lien that arises out of common law, wherein the parties have agreed in writing that a certain property will be held as security for a debt.
- equitable right of redemption** The right of a defaulted borrower to redeem property before foreclosure upon full payment of the outstanding debt, as well as accrued interest and related costs prior to the foreclosure.
- equitable title** The interest held by a vendee under a contract for deed or a sales contract; the equitable right to obtain absolute ownership to property when legal title is held in another's name; an insurable interest.
- equity** The interest or value that an owner has in a property over and above any mortgage indebtedness.
- erosion** The gradual wearing away of land by water, wind, and general weather conditions; the diminishing of property caused by the elements.
- errors and omissions insurance** An insurance that protects brokers from loss due to errors, mistakes, and negligence.

- escalation clause** A clause found in a mortgage or lease that allows the payment to adjust over the life of the mortgage or lease.
- escheat** The reversion of property to the state in the event the owner thereof dies without leaving a will and has no heirs to whom the property may pass by lawful descent.
- escrow** The closing of a transaction through a third party, called an *escrow agent* or *escrowee*, who receives certain funds and documents to be delivered on the performance of certain conditions in the escrow agreement.
- escrow moneys** From 2020 RELA: "all moneys, promissory notes or any other type or manner of legal tender or financial consideration deposited with any person for the benefit of the parties to the transaction. A transaction exists once an agreement has been reached and an accepted real estate contract signed or lease agreed to by the parties. Escrow moneys includes without limitation earnest moneys and security deposits, except those security deposits in which the person holding the security deposit is also the sole owner of the property being leased and for which the security deposit is being held."
- estate for years** An interest for a certain, exact period of time in property leased for a specified consideration.
- estate in land** The degree, quantity, nature, and extent of interest that a person has in real property.
- estate in severalty** An estate owned by one person.
- estoppel certificate** A legal instrument executed by a mortgagor showing the amount of the unpaid balance due on a mortgage and stating that the mortgagor has no defenses or offsets against the mortgagee at the time of execution of the certificate. Also called a *certificate of no defense*.
- ethical** Conforming to professional standards of conduct.
- eviction** A legal process to oust a person from possession of real estate.
- evidence of title** A proof of ownership of property, which is commonly a certificate of title, a title insurance policy, an abstract of title with lawyer's opinion, or a Torrens registration certificate.
- exchange** A transaction in which all or part of the consideration for the purchase of real property is the transfer of like-kind property (that is, real estate for real estate).
- exclusive-agency buyer agency agreement** A buyer brokerage agreement wherein the broker is entitled to a payment only if the broker locates the property the buyer purchases. The buyer can find property without the services of the agent.
- exclusive-agency listing** A listing contract under which the owner appoints a real estate broker as an exclusive agent for a designated period of time to sell the property on the owner's stated terms for a commission. However, the owner reserves the right to sell without paying anyone a commission by selling to a prospect who has not been introduced or claimed by the broker.
- exclusive brokerage agreement** From 2020 RELA: "a written brokerage agreement that provides that the sponsoring broker has the sole right, through one or more sponsored licensees, to act as the exclusive agent or representative of the client and that meets the requirements of Section 15-75 of this Act."
- exclusive buyer agency agreement** An exclusive-agency agreement wherein the buyer is legally bound to compensate the agent whenever the buyer purchases a property of the type described in the contract. This is true even if the buyer finds the property.
- exclusive-right-to-sell listing** A listing contract under which the owner appoints a real estate broker as the owner's exclusive agent for a designated period of time to sell the property on the owner's stated terms and agrees to pay the broker a commission when the property is sold, whether by the broker, the owner, or another broker.
- exculpatory clause** A hold harmless clause that may be found in contracts excusing a party for injuries to another.
- executed contract** A contract in which all parties have fulfilled their promises and thus performed the contract.
- execution** The signing and delivery of an instrument. Also, a legal order directing an official to enforce a judgment against the property of a debtor.
- executor** The male designated in a will to handle the estate of the deceased.
- executory contract** A contract under which something remains to be done by one or more of the parties.

- executrix** The female designated in a will to handle the estate of the deceased. The probate court must approve any sale of property by the executrix.
- expenses** The short-term costs that are deducted from an investment property's income, such as minor repairs, regular maintenance, and renting costs.
- expressed contract** An oral or written contract in which the parties state their terms and express their intentions in words.
- familial status** A protected class under federal fair housing law. A landlord cannot refuse to rent to a head of the household with minor children or to a pregnant woman.
- Federal Fair Housing Act** The term for Title VIII of the Civil Rights Act enacted in 1968 that prohibits discrimination based on race, color, sex, religion, or national origin in the sale and rental of residential property.
- Federal Home Loan Bank System** A system created by the Federal Home Loan Bank Act of 1932 to provide for a central reserve credit system for savings institutions engaged in home mortgage finance (predominantly savings and loans). The system is divided into 12 federal home loan bank districts with an FHLB in each district. The FHLBs maintain a permanent pool of credit to maintain liquidity of members or to provide means for mortgage lending when local funds are insufficient. Three sources of funds are available for the operation of the FHLB: (1) capital stock, (2) deposits of member institutions, and (3) consolidated obligations sold on the market. When member associations need funds, they obtain money by borrowing from FHLB. The FHLB Board supervises the system. The board is composed of three members appointed by the president of the United States with the advice and consent of the Senate.
- Federal Home Loan Mortgage Corporation** A member of the secondary mortgage market that primarily buys conventional loans.
- Federal Housing Administration (FHA)** A federal administrative body created by the National Housing Act in 1934 to encourage improvement in housing standards and conditions, to provide an adequate home financing system through the insurance of housing mortgages and credit, and to exert a stabilizing influence on the mortgage market.
- federal income tax** An annual tax based on income, including monies derived from the lease, use, or operation of real estate.
- Federal National Mortgage Association (FNMA)** Fannie Mae is the popular name for this federal agency that creates a secondary market for existing mortgages. FNMA does not loan money directly, but rather buys VA, FHA, and conventional loans.
- Federal Reserve banks** The government controls banks located in each of the 12 Federal Reserve districts, established by the Federal Reserve Act of 1913. The Board of Governors, working closely with the president and the U.S. Treasury, controls the Federal Reserve. The Federal Reserve system (through the 12 central banks) supervises and examines members' commercial banks; clears and collects checks drawn on commercial banks; and may influence the cost, supply, and availability of money.
- fee simple absolute** The highest form of ownership recognized by law. Also known as *fee simple* or *ownership in fee*.
- fee simple defeasible with a special limitation** Also known as a *fee simple determinable estate*. An estate created with a special limitation. Title would automatically revert back to the grantor or the grantor's heirs if the estate ceased to be used for the special limitation.
- fee simple estate** The maximum possible estate or right of ownership of real property continuing forever. Sometimes called a *fee* or *fee simple absolute*.
- fee simple subject to a condition subsequent** A defeasible fee estate in which the grantor reserves right of reentry to the property when the condition of ownership is violated.
- FHA appraisal** A Federal Housing Administration (FHA) evaluation of a property as security for a loan. Includes study of the physical characteristics of the property and surroundings; the location of the property; the prospective borrower's ability and willingness to repay a loan; and the mortgage amount and monthly payments.



- FHA loan** A loan insured by the FHA and made by an approved lender in accordance with the FHA's regulations.
- fiduciary relationship** A relationship of trust and confidence, as between trustee and beneficiary, attorney and client, and principal and agent.
- financing statement** See Uniform Commercial Code.
- first mortgage** A mortgage that creates a superior voluntary lien on the property mortgaged relative to other charges or encumbrances against same.
- fixture** An article that was once personal property but has been so affixed to real estate that it has become real property.
- floor area ratio (FAR)** The FAR indicates the relationship between a building area and land, or the relationship between the square footage of the building and the square footage of the land.
- forcible entry and detainer** A summary proceeding for restoring to possession of land one who is wrongfully kept out or has been wrongfully deprived of the possession.
- foreclosure** A legal procedure whereby property used as security for a debt is sold to satisfy the debt in the event of default in payment of the mortgage note or default of other terms in the mortgage document. The foreclosure procedure brings the rights of all parties to a conclusion and passes the title in the mortgaged property to either the holder of the mortgage or a third party who may purchase the realty at the foreclosure sale, free of all encumbrances affecting the property subsequent to the mortgage.
- formal will** A will written by an attorney, with two subscribing witnesses and with necessary language. Such a will may appoint the executor of the estate as independent agent and avoid the necessity of a bond.
- fractional sections** An oversized or undersized section that is not exactly one mile by one mile is a fractional section; used only in the government or rectangular survey.
- fraud** A misstatement of a material fact made with intent to deceive or made with reckless disregard of the truth and that actually does deceive.
- freehold estate** An estate in land in which ownership is for an indeterminate length of time, in contrast to a leasehold estate.
- front feet** A unit of linear measurement of the side of a property that faces the street.
- functional obsolescence** The impairment of functional capacity or efficiency. Functional obsolescence reflects the loss in value brought about by factors that affect the property, such as overcapacity, inadequacy, or changes in the design. The inability of a structure to perform adequately the function for which it is currently employed.
- future interest** A person's present right to an interest in real property that will not result in possession or enjoyment until sometime in the future, such as a reversion or right of reentry.
- gap** A defect in the chain of title of a particular parcel of real estate; a missing document or conveyance that raises doubt as to the present ownership of the land.
- general agent** A party authorized to perform all acts of the principal's affairs within the continued operation of a particular job or business.
- general contractor** A construction specialist who enters into a formal construction contract with a landowner or master lessee to construct a real estate building or project. The general contractor often contracts with several subcontractors specializing in various aspects of the building process to perform individual jobs.
- general lien** A lien on all real and personal property owned by a debtor.
- general partnership** See partnership. general tax See ad valorem tax.
- general warranty deed** A deed that states that the title conveyed therein is good from the sovereignty of the soil to the grantee therein; no one else can claim the property.
- GI-guaranteed mortgage** See VA loan.
- government lot** Those fractional sections in the rectangular (government) survey system that are less than one full quarter-section in area.
- Government National Mortgage Association (GNMA) Ginnie Mae**, a federal agency and division of HUD that operates special assistance aspects of federally aided housing programs and participates in the secondary market through its mortgage-backed securities pools.

- graduated lease** A lease that provides for periodic step increases in the rental payments.
- graduated payment mortgage** A loan in which smaller payments are made in the early years and larger payments at some predetermined time. This may create negative amortization.
- grant** The act of conveying or transferring title to real property.
- grant deed** A type of deed that includes three basic warranties: (1) the owner warrants the right to convey the property, (2) the owner warrants that the property is not encumbered other than with those encumbrances listed in the deed, and (3) the owner promises to convey any after-acquired title to the property. Grant deeds are popular in states that rely heavily on title insurance.
- grantee** A person to whom real estate is conveyed; the buyer.
- granting clause** That portion of the deed that states the grantor's intention to transfer title and type of ownership interest conveyed.
- grantor** A person who conveys real estate by deed; the seller.
- gross lease** A lease of property under which a landlord pays all property charges regularly incurred through ownership, such as repairs, taxes, insurance, and operating expenses. Most residential leases are gross leases.
- gross rent multiplier (GRM)** A figure used as a multiplier of the gross rental income of a property to produce an estimate of the property's value.
- ground lease** A lease of land only, on which the tenant usually owns a building or is required to build his or her own building as specified in the lease. Such leases are usually long-term net leases; a tenant's rights and obligations continue until the lease expires or is terminated through default.
- growing-equity mortgage** A loan in which the monthly payments increase, with the increased amount being applied directly to the outstanding principal balance, thus decreasing the loan term.
- guaranteed sale plan** An agreement between broker and seller that if the seller's real property is not sold before a certain date, the broker will purchase it for a specified price.
- guardian** One who guards or cares for another person's rights and property. A guardian has legal custody of the affairs of a minor or a person incapable of taking care of his own interests, called a *ward*.
- habendum clause** The deed clause beginning *to have and to hold* that defines or limits the extent of ownership in the estate granted by the deed.
- heir** One who might inherit or succeed to an interest in land under the state law of descent when the owner dies without leaving a valid will.
- highest and best use** That possible use of land that will produce the greatest net income and thereby develop the highest land value.
- holdover tenancy** A tenancy whereby a lessee retains possession of leased property after the lessee's lease has expired and the landlord, by continuing to accept rent from the tenant, agrees to the tenant's continued occupancy as defined by state law.
- holographic will** A will that is written, dated, and signed in the handwriting of the maker, and that does not need to be notarized or witnessed to be valid.
- homeowners' insurance policy** A standardized package insurance policy that covers a residential real estate owner against financial loss from fire, theft, public liability, and other common risks.
- homeowners warranty program** An insurance program offered to buyers by some brokerages, warranting the property against certain defects for a specified period of time.
- homestead** The land, and the improvements thereon, designated by the owner as the owner's homestead and, therefore, protected by state law from forced sale by certain creditors of the owner.
- HUD** The Department of Housing and Urban Development, which regulates FHA and GNMA.
- hypothecation** A pledge of property to the lender without giving up possession rights.
- implied contract** A contract under which the agreement of the parties is demonstrated by their acts and conduct.
- implied grant** A method of creating an easement. One party may be using another's property for the benefit of both parties; for example, a sewer on a property.

**improvement** (1) Improvements on land—any structure, usually privately owned, erected on a site to enhance the value of the property; for example, buildings, fences, and driveways. (2) Improvements to land—usually a publicly owned structure, such as a curb, sidewalk, or sewer.

**inactive** From 2020 RELA: "a status of licensure where the licensee holds a current license under this Act, but the licensee is prohibited from engaging in licensed activities because the licensee is unsponsored or the license of the sponsoring broker with whom the licensee is associated or by whom he or she is employed is currently expired, revoked, suspended, or otherwise rendered invalid under this Act. The license of any business entity that is not in good standing with the Illinois Secretary of State, or is not authorized to conduct business in Illinois, shall immediately become inactive and that entity shall be prohibited from engaging in any licensed activities."

**income approach** The process of estimating the value of an income-producing property by capitalization of the annual net income expected to be produced by the property during its remaining useful life.

**increasing returns** When increased expenditures for improvements to a given parcel of land yield an increasing percentage return on investment, the principle of increasing returns applies.

**incurable depreciation** The cost of fixing the property will be more than the increase in value or the corrections are not physically possible.

**indefeasible fee** A title that cannot be defeated. Example: fee simple absolute.

**indemnification** An agreement to compensate someone for a loss.

**independent contractor** One who is retained to perform a certain act, but who is subject to the control and direction of another only as to the end result and not as to how he or she performs the act. Unlike an employee, an independent contractor pays for all his or her expenses, income, and Social Security taxes, and receives no employee benefits. Many real estate salespeople are independent contractors.

**index lease** A lease in which the rental payment is tied to some agreed-on index, such as the Consumer Price Index or the Wholesale Price Index.

**industrial property** All land and buildings used or suited for use in the production, storage, or distribution of tangible goods.

**installment contract** See contract for deed.

**installment sale** A method of reporting income received from the sale of real estate when the sales price is paid in two or more installments over two or more years. If the sale meets certain requirements, a taxpayer can postpone reporting such income to future years when the taxpayer's other income may be lower.

**insurable title** A title to land that a title company will insure.

**insurance** The indemnification against loss from a specific hazard or peril through a contract (called a *policy*) and for a consideration (called a *premium*).

**intangible property** Personal property that cannot be physically touched, such as stock or a lease.

**interest** A charge made or paid by a lender for the use of money.

**interim financing** A short-term loan usually made during the construction phase of a building project, often referred to as a *construction loan*.

**inter vivos trust** A living trust created by an owner during the owner's lifetime.

**intestate** The condition of a property owner who dies without leaving a will. Title to such property will pass to the owner's heirs as provided in the state law of descent.

**invalid** In regard to contracts, it means having no legal force or effect.

**invalidate** to render null and void.

**investment** Money directed toward the purchase, improvement, and development of an asset in expectation of income or profits. A good financial investment has the following characteristics: safety, regularity of yield, marketability, acceptable denominations, valuable collateral, acceptable duration, required attention, and potential appreciation.

**involuntary alienation** The transfer of property against an owner's will. Example: foreclosure.

**involuntary lien** A lien that is placed on the property without the consent of the owner.

**IRS tax lien** A general, statutory, involuntary lien on all real and personal property owned by a debtor.

- joint tenancy** The ownership of real estate between two or more parties who have been named in one conveyance as joint tenants. Upon the death of a joint tenant, that tenant's interest passes to the surviving joint tenant or tenants by the right of survivorship.
- joint venture** The joining of two or more people to conduct a specific business enterprise. On the one hand, a joint venture is similar to a partnership in that it must be created by agreement between the parties to share in the losses and profits of the venture. On the other hand, it is unlike a partnership in that the venture is for one specific project only, rather than for a continuing business relationship.
- judgment** The official decision of a court on the respective rights and claims of the parties to an action or suit. When a judgment is entered and recorded with the county recorder, it usually becomes a general lien on the property.
- judgment clause** A provision that may be included in notes, leases, and contracts by which the debtor, lessee, or obligor authorizes any attorney to go into court to confess a judgment against the debtor for a default in payment. Also called a *cognovit*.
- judicial sale** A type of foreclosure in which the lender enforces the acceleration clause in the mortgage and files a suit to foreclose on the property.
- laches** An equitable doctrine used by courts to bar a legal claim or to prevent the assertion of a right because of undue delay, negligence, or failure to assert the claim or right.
- land** The earth's surface extending downward to the center of the earth and upward infinitely into space.
- land contract** The seller finances the property instead of a traditional lender. The seller holds title until final payment is made.
- landlocked** Property that does not have access to a public road to enter (ingress) or leave (egress) the land. This situation may create an easement by necessity.
- latent defect** A hidden defect in the property.
- law of agency** See agent.
- lawyer's opinion of title** See attorney's opinion of title.
- leads** From 2020 RELA: "the name or names of a potential buyer, seller, lessor, lessee, or client of a licensee."
- lease** A contract between a landlord (the lessor) and a tenant (the lessee) transferring the right to exclusive possession and use of the landlord's real property to the lessee for a specified period of time and for a stated consideration (rent). By state law, leases for longer than a certain period of time (generally one year) must be in writing to be enforceable.
- leased fee interest** The landlord's retained interest in the leased property is the leased fee interest.
- leasehold estate** A tenant's right to occupy real estate during the term of a lease, generally considered to be a personal property interest.
- leasehold interest** The tenant's interest in the leased property is the leasehold interest.
- lease option** This lease gives the tenant the option right to purchase the property within or at the end of the lease.
- lease purchase** The tenant leases property for a period of time with the intention of purchasing it.
- legal description** A description of a specific parcel of real estate sufficient for an independent surveyor to locate and identify it. The most common forms of legal description are rectangular survey; metes and bounds; lot, block (plat), and subdivision.
- legality of object** An element that must be present in a valid contract. All contracts that have for their object an act that violates the laws of the United States, or the laws of a state to which the parties are subject, are illegal, invalid, and not recognized by the courts.
- legal life estate** A life estate created by law, dower, curtesy, and homestead.
- legatee** A person who receives personal or real property under a will.
- lessee** The tenant who leases a property.
- lessor** One who leases property to a tenant.
- leverage** The use of borrowed money to finance the bulk of an investment.

- levy** to assess; to seize or collect. To levy a tax is to assess a property and set the rate of taxation. To levy an execution is to seize officially the property of a person to satisfy an obligation.
- license** From 2020 RELA: "the privilege conferred by the Department to a person that has fulfilled all requirements prerequisite to any type of licensure under this Act."
- licensee** From 2020 RELA: "any person, as defined in this Section, who holds a valid unexpired license as a managing broker, broker, or residential leasing agent."
- licensed activities** those activities listed in the definition of "broker" in this glossary."
- lien** A right given by law to certain creditors to have their debt paid out of the property of a defaulting debtor, usually by means of a court sale.
- Lienee** The party whose property is subject to a lien.
- lienor** The party holding the lien right.
- lien-theory state** A state in which the mortgage gives the mortgagee the right to place a lien on the property and the mortgagor retains title to the property.
- life estate** An interest in real or personal property that is limited in duration to the lifetime of its owner or some other designated person.
- life tenant** A person in possession of a life estate.
- liquidated damages** An amount predetermined by the parties to a contract as the total compensation the aggrieved party will receive should the other party breach the contract.
- liquidity** The ability to sell an asset and convert it into cash at a price close to its true value.
- lis pendens** Latin for action pending, which is recorded to give constructive notice that an action affecting the property (lawsuit) has been filed, but a judgment has not been decreed. A lis pendens notice renders the property unmarketable.
- listing agreement** A contract between a landowner (as principal) and a licensed real estate broker (as agent) by which the broker is employed as agent to sell real estate on the owner's terms within a given time, for which service the landowner agrees to pay a commission.
- listing broker** The broker in a multiple-listing situation from whose office a listing agreement is initiated, as opposed to the selling broker, from whose office negotiations leading up to a sale are initiated. The listing broker and the selling broker may, of course, be the same person. *See also* multiple listing.
- listing presentation** From 2020 RELA: " any communication, written or oral and by any means or media, between a managing broker or broker and a consumer in which the licensee is attempting to secure a brokerage agreement with the consumer to market the consumer's real estate for sale or lease."
- littoral rights** (1) A landowner's claim to use water in large lakes and oceans adjacent to the landlord's property. (2) The ownership's rights to land bordering these bodies of water up to the high-water mark.
- loan-to-value** The relationship between the amount of a loan and the appraised value of a property. It is expressed as a percentage of the appraised value.
- lock-in clause** (1) The lender's agreement to lock in an interest rate for a specified time period. (2) A condition in a promissory note that prohibits prepayment of the note.
- lot-and-block description** A description of real property that identifies a parcel of land by reference to lot and block numbers within a subdivision, as identified on a subdivided plat duly recorded in the county recorder's office.
- managing broker** From 2020 RELA: " a licensee who may be authorized to assume responsibilities as a designated managing broker for licensees in one or, in the case of a multi-office company, more than one office, upon appointment by the sponsoring broker and registration with the Department. A managing broker may act as his or her own sponsor."
- management agreement** A contract between the owner of income property and a management firm or individual property manager outlining the scope of the manager's authority.
- marketable title** A good or clear salable title reasonably free from risk of litigation over possible defects; also called a *merchantable title*.

- market-date approach** That approach in analysis that is based on the proposition that an informed purchaser would pay no more for a property than the cost to him of acquiring an existing property with the same utility. This approach is applicable when an active market provides sufficient quantities of reliable data that can be verified from authoritative sources. The approach is relatively unreliable in an inactive market or in estimating the value of properties for which no real comparable sales data are available. It is also questionable when sales data cannot be verified with principals to the transaction. Also referred to as the *market comparison* or *direct sales comparison approach*.
- market price** The actual selling price of a property.
- market rent** Also known as *economic rent*; the rental income that real estate could command in the market at any given time, versus *contract rent*, which is the income generated under the current lease contract.
- market value** The highest price that a property will bring in a competitive and open market under all conditions requisite to a fair sale. The price at which a buyer would buy and a seller would sell, each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus.
- master deed** A document that legally establishes the condominium regime. It is referred to as a *condominium declaration* and fully describes each unit and common elements, as well as specific essential elements of ownership that govern its operation.
- master plan** A master plan provides the guidelines for the future development of a community.
- mechanic's lien** A statutory lien created in favor of contractors, laborers, and materialmen who have performed work or furnished materials in erecting or repairing a building.
- medium of advertising** From 2020 RELA: " any method of communication intended to influence the general public to use or purchase a particular good or service or real estate, including, but not limited to, print, electronic, social media, and digital forums."
- metes-and-bounds description** A legal description of a parcel of land that begins at a well-marked point and follows the boundaries, using direction and distances around the tract back to the place of beginning.
- mill** One-tenth of 1¢ (0.001). Some states use a mill rate to compute real estate taxes; for example, a rate of 52 mills would be 0.052 tax for each dollar of assessed valuation of a property.
- millage rate** A property tax rate obtained by dividing the total assessed value of all the property in the tax district into the total amount of revenue needed by the taxing district. This millage rate is then applied to the assessed value of each property in the district to determine individual taxes.
- ministerial acts** Acts performed by a licensee for a consumer that are informative in nature, but do not rise to the level of active representation, such as responding to inquiries about a property's price range or providing other facts. Providing ministerial acts to a consumer does not replace non-agency relationship/disclosure.
- misrepresentation** To represent falsely; to give an untrue idea of a property. May be accomplished by omission or concealment of a material fact.
- money judgment** A court judgment ordering payment of money rather than specific performance of a certain action. See *also* judgment.
- money market** Those institutions —such as banks, savings and loan associations, and life insurance companies —whose function it is to supply money and credit to borrowers.
- month-to-month tenancy** A periodic tenancy; the tenant rents for one period at a time. In the absence of a rental agreement (oral or written), a tenancy is generally considered to be month to month.
- monument** A fixed natural or artificial object used to establish real estate boundaries for a metes-and-bounds description.
- mortgage** A conditional transfer or pledge of real estate as security for a loan. Also, **the** document creating a mortgage lien.
- mortgage bankers** A firm or individual who originates loans for sale to other investors.
- mortgage broker** A mortgage broker is a firm or person who brings borrowers and lenders together, and the finders' fee is normally paid by the lender, but it could be paid by the borrower.
- mortgage fraud** The lender is provided with false or misleading information on a loan application, or with falsified documents in the loan process.

- mortgagee** The lender who receives a pledge from a borrower to repay a loan.
- mortgage lien** A lien or charge on a mortgagor's property that secures the underlying debt obligations.
- mortgagor** One who, having all or part of title to property, pledges that property as security for a debt; the borrower.
- multiple listing** An exclusive listing (generally, an exclusive-right-to-sell) with the additional authority and obligation on the part of the listing broker to distribute the listing to other brokers in the multiple-listing organization.
- municipal ordinances** The laws, regulations, and codes enacted by the governing body of a municipality.
- mutual rescission** The act of putting an end to a contract by mutual agreement of the parties.
- negative amortization** A loan in which the loan balance increases with each payment rather than decreasing because the payment amount is not sufficient to cover the interest.
- negligence** Carelessness and inattentiveness resulting in violation of trust. Failure to do what is required.
- net income** The gross income of a property minus operating expenses (not including debt service).
- net lease** A lease requiring the tenant to pay not only rent, but also **all** costs incurred in maintaining the property, including taxes, insurance, utilities, and repairs.
- net listing** A listing establishing a price, which must be expressly agreed on, below which the owner will not sell the property and at which price the broker will not receive a commission; the broker receives the excess over and above the net listing price as commission.
- nonconforming loan** A loan that does not meet secondary market standards.
- nonconforming use** A use of property that is permitted to continue after a zoning ordinance prohibiting it has been established for the area. Also, a use of property that is not conforming to current zoning because of a change in zoning, such as property being used for residential purposes, but currently zoned commercial.
- non-disturbance clause** A clause found in a lease that protects the tenant. **If** the landlord defaults on payments to the lender, the lender has the right to collect rent from the tenant. If the tenant pays the lender, the tenant cannot be evicted.
- nonhomogeneity** A lack of uniformity; dissimilarity. As no two parcels of land are exactly alike, real estate is said to be unique or nonhomogeneous.
- nonjudicial foreclosure** Also known as *foreclosure by advertisement* because it is a foreclosure procedure where the lender does not have to involve the courts.
- nonrecourse loan** A loan in which the property being pledged as collateral is the sole security for the loan. The borrower cannot be held personally liable for the note.
- notarize** To certify or attest to a document, as by a notary.
- notary public** A public official authorized to certify and attest to documents, take affidavits, take acknowledgments, administer oaths, and perform other such acts.
- note** An instrument of credit given to attest a debt.
- notice of abandonment** An instrument filed to release a recorded declaration of homestead.
- novation** Substituting a new contract for an old one and the release of liability.
- obligee/promisee** The lender in the note.
- obligor/promissor** The borrower in a note.
- obsolescence** To be obsolete as used in appraising the loss of value because it is outdated or less useful.
- offer and acceptance** The two components of a valid contract; a *meeting of the minds*.
- office** From 2020 RELA: "a broker's place of business where the general public is invited to transact business and where records may be maintained and licenses displayed, whether or not it is the broker's principal place of business."
- officer's deed** A deed by sheriffs, trustees, guardians, and the like.
- one hundred percent-commission plan** A salesperson compensation plan whereby the salesperson pays the salesperson's broker a monthly service charge to cover the costs of office expenses and receives 100 percent of the commissions from the negotiated sales.

- open buyer agency agreement** A nonexclusive agency contract between a broker and a buyer wherein the buyer may enter into similar agreements with an unlimited number of brokers; the broker is paid who locates the property the buyer purchases.
- open-end mortgage** A mortgage loan that is expandable by increments up to a maximum dollar amount, all of which is secured by the same original mortgage.
- open listing** A listing contract under which the broker's commission is contingent on the broker's producing a ready, willing, and able buyer before the property is sold by the seller or another broker; the principal (owner) reserves the right to list the property with other brokers.
- open mortgage** An open mortgage is a mortgage without a prepayment clause. FHA-insured and VA-guaranteed mortgages are open mortgages.
- option** The right to purchase property within a definite time at a specified price. No obligation to purchase exists, but the seller is obligated to sell if the option holder exercises right to purchase.
- optionee** The party that receives and holds an option.
- optionor** The party that grants or gives an option.
- ownership** The exclusive right to hold, possess, or control and dispose of a tangible or intangible thing. Ownership may be held by a person, corporation, or political entity.
- package mortgage** A method of financing in which the loan that finances the purchase of a home also finances the purchase of certain items of personal property, such as a washer, dryer, refrigerator, stove, and other specified appliances.
- participation financing** A mortgage in which the lender participates in the income of the mortgaged venture beyond a fixed return or receives a yield on the loan in addition to the straight interest rate.
- partnership** An association of two or more individuals who carry on a continuing business for profit as co-owners. Under the law, a partnership is regarded as a group of individuals, rather than as a single entity. A general partnership is a typical form of joint venture, in which each general partner shares in the administration, profits, and losses of the operation. A limited partnership is a business arrangement whereby the operation is administered by one or more general partners and funded by limited or silent partners who are by law responsible for losses only to the extent of their investment.
- party wall** A wall that is located on or at a boundary line between two adjoining parcels for the use of the owners of both properties.
- patent defect** A defect that can be found by normal inspection of the property.
- payee** The party that receives payment.
- payor** The party that makes payment to another.
- percentage lease** A lease commonly used for retail property in which the rental is based on the tenant's gross sales at the premises; often stipulates a base monthly rental plus a percentage of any gross sales above a certain amount.
- periodic estate** An interest in leased property that continues from period to period—week to week, month to month, or year to year.
- person** From 2020 RELA: "means and includes individuals, entities, corporations, limited liability companies, registered limited liability partnerships, foreign and domestic partnerships, and other business entities, except that when the context otherwise requires, the term may refer to a single individual or other described entity."
- personal property** Those items, called chattels, that are not classified as real property, tangible, and movable objects.
- physical deterioration** A reduction in utility resulting from an impairment of physical condition. For purposes of appraisal analysis, it is most common and convenient to divide physical deterioration into curable and incurable components.
- plat** A map of a town, section, or subdivision indicating the location and boundaries of individual properties.
- plat book** A record of recorded subdivisions of land.
- plottage** The value that is created when two or more tracts of land are merged into a single, larger one.



- point** A unit of measurement used for various loan charges. One point equals 1 percent of the amount of the loan.  
See also discount points.
- point of beginning** The starting point of the survey situated in one corner of the parcel in a metes-and-bounds legal description. All metes-and-bounds descriptions must follow the boundaries of the parcel back to the point of beginning.
- police power** The government's right to impose laws, statutes, and ordinances to protect the public health, safety, and welfare, including zoning ordinances and building codes.
- power of attorney** A written instrument authorizing a person (the attorney-in-fact) to act on behalf of the maker to the extent indicated in the instrument.
- premises** The specific section of a deed that states the names of the parties, recital of consideration, operative words of conveyance, legal property description, and appurtenance provisions.
- prepayment penalty** A charge imposed on a borrower by a lender for early payment of the loan principal to compensate the lender for interest and other charges that would otherwise be lost.
- prepayment privilege clause** The statement of the terms upon which the mortgagor may pay the entire or stated amount of the mortgage principal at some time prior to the due date.
- prescription** The right or easement to land that is acquired by adverse possession or *squatter's rights*. It must be acquired under certain conditions as required by law.
- prescriptive title** A title that is acquired by an adverse possession claim.
- price fixing** See antitrust laws.
- primary mortgage market** The market where a person or business goes to negotiate a loan.
- principal** (1) A **sum** lent or employed as a fund or investment, as distinguished from its income or profits. (2) The original amount (as in a loan) of the total due and payable at a certain date. (3) A main party to a transaction—the person for whom the agent works.
- principal meridian** One of 35 north and south survey lines established and defined as part of the rectangular (government) survey system.
- principle of conformity** The appraisal theory stating that buildings that are similar in design, construction, and age to other buildings in the area have a higher value than they would in a neighborhood of dissimilar buildings.
- principle of substitution** The appraisal theory that states that no one will pay more for a property than the cost of buying or building a similar property; or, in the case of investments, the price of a substitute investment.
- priority** The order of position or time. The priority of liens is generally determined by the chronological order in which the lien documents are recorded; tax liens, however, have priority even over previously recorded liens.
- private mortgage insurance (PMI)** Insurance written by a private company (not government) that protects a lender against loss if a borrower defaults.
- probate** The formal judicial proceeding to prove or confirm the validity of a will.
- procuring cause** The effort that brings about the desired result. Under an open listing, the broker who is the procuring cause of the sale receives the commission.
- progression** When a small structure is placed in an area of larger more expensive structures, the value of the smaller structure will increase.
- property management** The operation of the property of another for compensation. Includes marketing of space; advertising and rental activities; collection, recording, and remitting of rents; maintenance of the property; tenant relations; hiring of employees; keeping proper accounts; and rendering periodic reports to the owner.
- property tax** Those taxes levied by the government against either real or personal property. The right to tax real property in the United States rests exclusively with the states, not with the federal government.
- proprietary lease** A lease given by the corporation that owns a cooperative apartment building to the shareholder, giving the shareholder (tenant) the right to occupy one of the units.
- proration** The proportionate division or distribution of expenses of property ownership between two or more parties. Closing statement prorations generally include taxes, rents, insurance, interest charges, and assessments.

- prospectus** A printed advertisement, usually in pamphlet form, presenting a new development, subdivision, business venture, or stock issue.
- public utility easement** A right granted by a property owner to a public utility company to erect and maintain poles, wires, and conduits on, across, or under the owner's land for telephone, electric power, gas, water, or sewer installation.
- puffing** An exaggerated opinion, many times in regard to a property's amenity.
- pur autre vie** A term meaning for the life of another. A life estate pur autre vie is a life estate that is measured by the life of a person other than the grantee.
- purchase-money mortgage** A note secured by a mortgage or deed of trust given by a buyer, as mortgagor, to a seller, as mortgagee, as part of the purchase price of the real estate.
- pyramiding** Obtaining additional investment property by borrowing against the equity of existing investments.
- qualification** The act of determining the prospect's needs, abilities, and urgency to buy and then matching these with available properties.
- quiet enjoyment** A covenant in a deed that the title being given is good against third parties.
- quiet title lawsuit** A suit to clear up any defects or clouds on a title.
- quitclaim deed** A conveyance by which the grantor transfers whatever interest the grantor has in the real estate without warranties or obligations.
- range** A strip of land six miles wide, extending north and south and numbered east and west according to its distance from the principal meridians in the rectangular survey system (government survey method) of land description.
- ready, willing, and able buyer** One who is prepared to buy property on the seller's terms and is ready to take positive steps to consummate the transaction.
- real estate** From 2020 RELA: "means and includes leaseholds as well as any other interest or estate in land, whether corporeal, incorporeal, freehold, or non-freehold and whether the real estate is situated in this State or elsewhere. "Real estate" does not include property sold, exchanged, or leased as a timeshare or similar vacation item or interest, vacation club membership, or other activity formerly regulated under the Real Estate Timeshare Act of 1999 (repealed)."
- real estate broker** See *also* broker.
- real estate investment trust (REIT)** Trust ownership of real estate wherein a group of individuals purchases certificates of ownership in the trust, which purchases property and distributes the profits back to the investors free of corporate income tax.
- Real Estate Settlement Procedures Act (RESPA)** The federal law ensuring that the buyer and seller in a real estate transaction have knowledge of all settlement costs when the purchase of a one- to four-family residential dwelling is financed by a federally related mortgage loan. Federally related loans include those made by savings and loans, insured by the FHA or VA, administered by HUD, or intended to be sold by the lender to an agency.
- reality of consent** An element of all valid contracts. Offer and acceptance in a contract are usually taken to mean that reality of consent is also present. This is not the case if any of the following are present, however: mistake, misrepresentation, fraud, undue influence, or duress.
- real property** Real property, or real estate as it is often called, consists of land, anything affixed to it so as to be regarded as a permanent part of the land, that which is appurtenant to the land, and that which is immovable by law.
- REALTOR®** A registered trademark term reserved for the sole use of active members of local REALTOR® boards affiliated with the National Association of REALTORS®.
- receiver** The court-appointed custodian of property involved in litigation, pending final disposition of the matter before the court.
- reconciliation** The final step in the appraisal process, in which the appraiser reconciles the estimates of value received from the market-data, cost, and income approaches to arrive at a final estimate of market value for the subject property.

- recording** The act of entering or recording documents affecting or conveying interests in real estate in the recorder's office established in each county. Until recorded, a deed or mortgage generally is not effective against subsequent purchases or mortgage liens.
- recovery fund** A fund established in some states from real estate license funds to cover claims of aggrieved parties who have suffered monetary damage through the actions of a real estate licensee.
- rectangular survey system** A system established in 1785 by the U.S. government, providing for surveying and describing land by reference to principal meridians and base lines.
- redemption period** A period of time established by state law during which a property owner has the right to redeem his or her real estate from a foreclosure or tax sale by paying the sales price, interest, and costs. Many states do not have mortgage redemption laws.
- redlining** The illegal practice of some institutions of denying loans or restricting their number for certain areas of a community.
- regression** When a large structure is placed in an area of smaller, less expensive structures, the value of the larger structure will decrease.
- regular employee** From 2020 RELA: "a person working an average of 20 hours per week for a person or entity who would be considered as an employee under the Internal Revenue Service rules for classifying workers."
- release** To relinquish an interest in or claim to a parcel of property.
- reliction** When water recedes, new land is acquired by reliction.
- relocation service** An organization that aids a person in selling a property in one area and buying another property in another area.
- remainder** The remnant of an estate that has been conveyed to take effect and be enjoyed after the termination of a prior estate, such as when an owner conveys a life estate to one party and the remainder to another.
- remainder interest** A third party who has a future ownership interest in the property upon the death of the life tenant. *See also* life estates.
- renewal period** From 2020 RELA: "the period beginning 90 days prior to the expiration date of a license"
- rent** A fixed, periodic payment made by a tenant of a property to the owner for possession and use, usually by prior agreement of the parties.
- rent control** The regulation by the state or local government agencies restricting the amount of rent landlords can charge their tenants.
- rent schedule** A statement of proposed rental rates, determined by the owner or the property manager or both, based on a building's estimated expenses, market supply, and demand and the owner's long-range goals for the property.
- replacement cost** The cost of construction at current prices of a building having utility equivalent to the building being appraised but built with modern materials and according to current standards, design, and layout. The use of the replacement cost concept presumably eliminates all functional obsolescence, and the only depreciations to be measured are physical deterioration and economic obsolescence.
- reproduction cost** The cost of construction at current prices of an exact duplicate or replica using the same materials, construction standards, design, layout, and quality of workmanship and embodying all the deficiencies, superadequacies, and obsolescences of the subject building.
- rescission** The termination of a contract by mutual agreement of the parties.
- reservation in a deed** The creation by a deed to property of a new right in favor of the grantor. Usually involves an easement, life estate, or a mineral interest.
- residential leasing agent** From 2020 RELA: "a person who is employed by a broker to engage in licensed activities limited to leasing residential real estate who has obtained a license as provided for in Section 5-5 of this Act."
- restriction** A limitation on the use of real property, generally originated by the owner or subdivider in a deed.
- reverse mortgage** A mortgage that allows senior homeowners 62 years of age or older to release a percent of the equity in their property without making monthly payments. The loan is repaid when the borrower no longer resides in the property.

- reversion** The remnant of an estate that the grantor holds after the grantor has granted a life estate to another person; the estate will return or revert to the grantor; also called a *reverser*.
- reversionary right** An owner's right to regain possession of leased property upon termination of the lease agreement.
- rezoning** The process involved in changing the existing zoning of a property or area.
- right of first refusal** A potential buyer's right to meet the terms of the sales contract.
- right of survivorship** See joint tenancy.
- riparian rights** An owner's rights in land that borders on or includes a stream, river, lake, or sea. These rights include access to and use of the water.
- sale and leaseback** A transaction in which an owner sells his or her improved property and, as part of the same transaction, signs a long-term lease to remain in possession of the premises.
- sales comparison approach** Also known as the *market approach to appraising*. It is used to appraise residential property or vacant land that will be used for residential purposes. It is based on the principle of substitution.
- sales contract** A contract containing the complete terms of the agreement between buyer and seller for the sale of a particular parcel or parcels of real estate.
- salesperson** A person who performs real estate activities while employed by, or associated with, a licensed real estate broker.
- sandwich lease** The lessee's interest in a sublease is the sandwich lease.
- satisfaction** A document acknowledging the payment of a debt.
- secondary mortgage market** A market for the purchase and sale of existing mortgages, designed to provide greater liquidity for mortgages; also called the *secondary money market*.
- Secretary** From 2020 RELA: "the Secretary of the Department of Financial and Professional Regulation, or a person authorized by the Secretary to act in the Secretary's stead."
- section** A portion of a township under the rectangular survey system (government survey method). A township is divided into 36 sections numbered 1 to 36. A section is a square with mile-long sides and an area of 1 square mile or 640 acres.
- security deposit** A payment made by the tenant that the landlord holds during the lease term and that may be kept wholly or in part on default or destruction of the premises by the tenant.
- selling broker** See listing broker.
- separate property** The real property owned by a husband or wife prior to their marriage.
- servient tenement** The land on which an easement exists in favor of an adjacent property (called a *dominant estate*); also called a *servient estate*.
- setback** The amount of space local zoning regulations require between a lot line and a building line.
- severalty** The ownership of real property by one person only, also called *sole ownership*.
- severance** The process of changing real property to personal property.
- shared participation mortgage** A type of participation mortgage in which the lender shares in the appreciation of the mortgaged property when the property is sold.
- short sale** A lender process where the bank and seller agree to take less than the amount owed on the property.
- situs** The personal preference of people for one area over another, not necessarily based on objective facts and knowledge.
- sole ownership** See severalty.
- special agent** A party authorized to perform with limited authority given by the principal.
- special assessment** A tax or levy customarily imposed against only those specific parcels of real estate that will benefit from a proposed public improvement, such as a street or sewer.
- special warranty deed** A deed in which the grantor warrants or guarantees the title only against defects arising during the period of the grantor's tenure and ownership of the property and not against defects existing before that time, generally using the language, *by, through, or under the grantor but not otherwise*.
- specific lien** A lien affecting or attaching only to a certain, specific parcel of land or piece of property.

- specific performance suit** A legal action brought in a court of equity in special cases to compel a party to carry out the terms of a contract. The basis for an equity court's jurisdiction in breach of a real estate contract is the fact that land is unique and mere legal damages would not adequately compensate the buyer for the seller's breach.
- sponsorship** From 2020 RELA: "means that a sponsoring broker has certified to the Department that a managing broker, broker, or residential leasing agent named thereon is employed by or associated by written agreement with the sponsoring broker and the Department has registered the sponsorship, as provided for in Section 5-40 of this Act."
- sponsoring broker** From 2020 RELA: "the broker who certifies to the Department his, her, or its sponsorship of a licensed managing broker, broker, or a residential leasing agent."
- squatter's rights** Those rights acquired through adverse possession. By *squatting* on land for a certain statutory period under prescribed conditions, one may acquire title by limitations. If an easement only is acquired, instead of title to the land itself, one has title by prescription.
- statute of frauds** The part of a state law that requires that certain instruments, such as deeds, real estate sales contracts, and certain leases, be in writing in order to be legally enforceable.
- statute of limitation** That law pertaining to the period of time within which certain actions must be brought to court.
- statutory lien** A lien imposed on property by statute, such as a tax lien, in contrast to a voluntary lien that an owner places on the owner's own real estate, such as a mortgage lien.
- statutory right of redemption** In some states, defaulted borrowers have the statutory right of redemption, which allows them to buy back their property after the foreclosure sale by paying the sales price, interest, and costs.
- steering** The illegal practice of channeling home seekers to particular areas, either to maintain the homogeneity of an area or to change its character in order to create a speculative situation.
- stigmatized property** A property is considered stigmatized or undesirable because of events that have occurred on the property.
- straight-line method** A method of calculating depreciation for tax purposes, computed by dividing the adjusted basis of a property less its estimated salvage value by the estimated number of years of remaining useful life.
- strict foreclosure** A foreclosure procedure in which the lender secures title and all equity to the property.
- subagent** An agent of an agent. The broker is the agent of the principal. The salesperson is a subagent of the principal.
- subcontractor** See general contractor.
- subdivision** A tract of land divided by the owner, known as the *subdivider*, into blocks, building lots, and streets according to a recorded subdivision plat, which must comply with local ordinances and regulations.
- subletting** The leasing of premises by a lessee to a third party for part of the lessee's remaining term. See *a/s/o* assignment.
- subordination** A relegation to a lesser position, usually in respect to a right or security.
- subrogation** The substitution of one creditor for another, with the substituted person succeeding to the legal rights and claims of the original claimant. Subrogation is used by title insurers to acquire rights to sue from the injured party to recover any claims they have paid.
- substitution** An appraisal principle that states that the maximum value of a property tends to be set by the cost of purchasing an equally desirable and valuable substitute property, assuming that no costly delay is encountered in making the substitution.
- suit for partition** A legal action to divide the ownership interests in a property.
- suit for possession** A court suit initiated by a landlord to evict a tenant from leased premises after the tenant has breached one of the terms of the lease or has held possession of the property after the lease's expiration.
- suit for specific performance** A legal action brought by either a buyer or a seller to enforce performance of the terms of a contract.
- suit to quiet title** A legal action intended to establish or settle the title to a particular property, especially when there is a cloud on the title.

- summation appraisal** An approach under which value equals estimated land value plus reproduction costs of any improvements, after depreciation has been subtracted.
- supply** The amount of goods available in the market to be sold at a given price. The term is often coupled with demand.
- surety bond** An agreement by an insurance or bonding company to be responsible for certain possible defaults, debts, or obligations contracted for by an insured party; in essence, a policy insuring one's personal and/or financial integrity. In the real estate business, a surety bond is generally used to ensure that a particular project will be completed at a certain date or that a contract will be performed as stated.
- survey** The process by which boundaries are measured and land areas are determined; the on-site measurement of lot lines, dimensions, and positions of buildings on a lot, including the determination of any existing encroachments or easements.
- syndicate** A combination of two or more persons or firms to accomplish a joint venture of mutual interest. Syndicates dissolve when the specific purpose for which they were created has been accomplished.
- tacking** Combining successive periods of property use; associated with adverse possession claims.
- tangible property** Property that can be seen and touched.
- taxation** The process by which a government or municipal quasi-public body raises monies to fund its operation.
- tax deed** An instrument, similar to a certificate of sale, given to a purchaser at a tax sale. *See also* certificate of sale.
- taxes** A compulsory contribution required by the government from persons, corporations, and other organizations, according to a law, for the general support of the government and for the maintenance of public services.
- tax lien** A charge against property created by operation of law. Tax liens and assessments take priority over all other liens.
- tax rate** The rate at which real property is taxed in a tax district or county. For example, in a certain county, real property may be taxed at a rate of 560 per dollar of assessed valuation. **tax sale** A court-ordered sale of real property to raise money to cover delinquent taxes.
- tax shelters** Allow a taxpayer to reduce current tax liability by offsetting income from one source with losses from another source.
- team** From 2020 RELA: "any 2 or more licensees who work together to provide real estate brokerage services, represent themselves to the public as being part of a team or group, are identified by a team name that is different than their sponsoring broker's name, and together are supervised by the same designated managing broker and sponsored by the same sponsoring broker. "Team" does not mean a separately organized, incorporated, or legal entity."
- tenancy at sufferance** The tenancy of a lessee who lawfully comes into possession of a landlord's real estate, but who continues to occupy the premises improperly after the lessee's lease rights have expired.
- tenancy at will** An estate that gives the lessee the right to possession until the estate is terminated by either party; the term of this estate is indefinite.
- tenancy by the entirety** The joint ownership, recognized in some states, of property acquired by husband and wife during marriage. Upon the death of one spouse, the survivor becomes the owner of the property.
- tenancy in common** A form of co-ownership by which each owner holds an undivided interest in real property as if that owner was the sole owner. Each individual owner has the right to partition. Unlike a joint tenancy, there is no right of survivorship between tenants in common.
- tenant** One who holds or possesses lands or tenements by any kind of right or title.
- tenement** Everything that may be occupied under a lease by a tenant.
- termination (lease)** The cancellation of a lease by action of either party. A lease may be terminated by expiration of term, surrender and acceptance, constructive eviction by lessor, or option when provided in lease for breach of covenants.
- termination (listing)** The cancellation of a broker-principal employment contract; a listing may be terminated by death or insanity of either party, expiration of listing period, mutual agreement, sufficient written notice, or the completion of performance under the agreement.

- term mortgage** A non-amortized loan in which the borrower makes periodic interest payments to the lender and the principal balance is due on maturity. Also known as a *straight mortgage*.
- testamentary trust** A trust created through a will after a property owner's death.
- testate** Having made and left a valid will.
- testator** A male will maker
- testatrix** A female will maker.
- time is of the essence** A phrase in a contract that requires the performance of a certain act within a stated period of time.
- time-share estate** A fee simple interest in an interval ownership of property for a specified time period. The owner's occupancy is limited to the time period purchased.
- time-share use** The right to use and occupy the property for a certain number of years. A time-share use may be conveyed by a lease or license.
- title** The legal evidence of ownership rights to real property.
- title insurance** Insurance that is designed to indemnify the holder for loss sustained for reason of defects in a title, up to and including the policy limits.
- title-theory states** A state in which a security instrument gives the mortgagee the title to the property.
- Torrens system** A method of evidencing title by registration with the proper public authority, generally called the registrar. Named for its founder, Sir Robert Torrens.
- township** The principal unit of the rectangular (government) survey system. A township is a square with 6-mile sides and an area of 36 square miles.
- township lines** The lines running at six-mile intervals parallel to the base lines in the rectangular (government) survey system.
- trade fixtures** The articles installed by a tenant under the terms of a lease and removable by the tenant before the lease expires. These remain personal property and are not true fixtures.
- transaction broker** A person who represents neither party in a transaction. Both parties are treated as customers.
- transfer taxes** Real estate transfer taxes or RETT are state, county, and/or municipal sales taxes most often used as general revenue.
- trust** A fiduciary arrangement whereby property is conveyed to a person or institution, called a *trustee*, to be held and administered on behalf of another person, called a *beneficiary*.
- trust deed** An instrument used to create a mortgage lien by which the mortgagor conveys title to a trustee, who holds it as security for the benefit of the note holder (the lender); also called a *deed of trust*.
- trustee** One who as agent for others handles money or holds title to their land.
- trustee's deed** A deed executed by a trustee conveying land held in a trust.
- trustor** A borrower in a deed of trust; a grantor in a deed in trust.
- Truth-in-Lending Act** Also known as Regulation Z, this act requires that the lender disclose the true cost of credit to individual borrowers for certain types of loans. It also regulates the advertisement of creditors.
- unconventional mortgage** An unconventional mortgage (loan) is backed by the government to reduce the lender's risk. Examples: FHA-insured loans and VA-guaranteed loans.
- unenforceable contract** A contract in which neither party can sue the other to force performance, such as a contract missing the signature of the person authorized to perform.
- undivided interest** An interest in a property that cannot be physically divided. *See also* tenancy in common.
- Uniform Commercial Code (UCC)** A codification of commercial law adopted in most states that attempts to make uniform all laws relating to commercial transactions, including chattel mortgages and bulk transfers. Security interests in chattels are created by an instrument known as a *security agreement*. Article 6 of the code regulates bulk transfers—the sale of a business as a whole, including all fixtures, chattels, and merchandise.

- unilateral contract** A one-sided contract wherein one party makes a promise in order to induce a second party to do something. The second party is not legally bound to perform; however, if the second party does comply, the first party is obligated to keep the promise.
- unity of ownership** The four unities that are traditionally needed to create a joint tenancy—unity of title, unity of time, unity of interest, and unity of possession.
- universal agent** An agent that represents a principal in all activities, such as someone given full power of attorney.
- useful life** In real estate investment, the number of years a property will be useful to the investors.
- usury** The practice of charging more than the rate of interest allowed by law.
- valid contract** A contract that complies with all the essentials of a contract and is binding and enforceable on all parties to it.
- valid deed** An enforceable deed that has a competent grantor and grantee, consideration, conveyance, legal description of land, signature of grantor, acknowledgment, delivery, and acceptance.
- valid lease** An enforceable lease that has the following essential parts: lessor and lessee with contractual capacity, offer and acceptance, legality of object, description of the premises, consideration, signatures, and delivery. Leases for more than one year must also be in writing.
- VA loan** A mortgage loan on approved property made to a qualified veteran by an authorized lender and guaranteed by the Department of Veterans Affairs to limit possible loss by the lender.
- variance** The permission obtained from zoning authorities to build a structure or conduct a use that is expressly prohibited by the current zoning laws; an exception from the zoning ordinances.
- vendee** The buyer or purchaser.
- vendor** The seller.
- voidable contract** A contract that seems to be valid but that may be rejected or disaffirmed by one of the parties.
- void contract** A contract that has no legal force or effect because it does not meet the essential elements of a contract.
- voluntary lien** A lien that is created intentionally by the property owner, such as a mortgage.
- voluntary transfer** See alienation.
- waiver** The intentional or voluntary relinquishment of a known claim or right.
- warranty deed** A deed in which the grantor fully warrants good clear title to the premises. Used in most real estate deed transfers, a warranty deed offers the greatest protection of any deed.
- warranty of habitability** In a lease, this warranty requires that the landlord keep the property in good condition; that is to maintain the property, equipment, and to comply with state and local codes.
- waste** An improper use or an abuse of a property by a possessor who holds less than fee ownership, such as a tenant, life tenant, mortgagor, or vendee. Such waste generally impairs the value of the land or the interest of the person holding the title or the reversionary rights.
- will** A written document, properly witnessed, providing for the transfer of title to property owned by the deceased, called the *testator*.
- wraparound mortgage** A method of refinancing in which the new mortgage is placed in a secondary, or subordinate, position. In essence, it is an additional mortgage in which another lender refinances a borrower by lending an amount over the existing first-mortgage amount without disturbing the existence of the first mortgage.
- writ of attachment** Action taken by a creditor wherein the court retains custody of the property while a lawsuit is being decided, thus preventing the debtor from transferring unsecured real estate before a judgment is rendered. This ensures that the property will be available to satisfy the judgment.
- writ of execution** A court order that authorizes and directs the proper officer of the court (usually the sheriff) to sell the property of a defendant as required by the judgment or decree of the court.
- year-to-year tenancy** A periodic tenancy in which rent is collected from year to year.
- zoning ordinance** An exercise of police power by a municipality to regulate and control the character and use of property.



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