

Pennsylvania Real Estate Practices

Chapter 12: Review

1 . Review

Congratulations on the completion of the content for the Pennsylvania Real Estate Practice course.

This chapter will be a review of everything you have covered in the previous eleven chapters. When you have finished this chapter, you'll be ready to move on to the exams.

So let's get started!

End of Page

2 . Review

The real estate industry is considered to be the largest industry in the United States.

We can say this industry is made up of individuals and companies that acquire, develop, operate, manage, lease, dispose of, sell and market real property.

Real estate professionals perform a wide-variety of real estate-related tasks that fall into one of several categories:

- Acquisition and development
- Investment
- Management
- Regulation
- Removal
- Sale or transfer

End of Page

3 . Review

Several kinds of property exist in the real estate market.

Residential property is defined as land or improved property with buildings designed for humans to live in, such as single-family homes, multi-family homes, apartments, vacation homes or condominiums.

Industrial property is land used for industrial purposes, such as warehouses, factories and power plants.

Commercial property refers to income-producing property, such as office buildings, restaurants, shopping centers, hotels and motels, parking lots and stores. Some industrial properties may also fall into this category.

End of Page

4 . Review

Agricultural property is defined as land used primarily for growing crops or raising livestock, such as farms, pastureland, orchards and timberland.

Special purpose property is property that has a unique use to the persons who own and use it, such as churches, hospitals, schools and government buildings.

Recreational property is land used for leisure activities, such as parks, forests, time-shares and campgrounds.

Investment property is defined as any property that is being held as an investment to generate income or profit. Any residential, commercial or industrial property may be considered an investment property. However, typically, most single-family residences are not considered investment properties, unless they are non-owner occupied.

End of Page

5 . Review

Brokers and salespersons can choose to specialize in different areas.

- **Type of property** – An agent can specialize in residential, commercial, industrial or land transactions.
- **Clients** – Rather than deal with all types of clients, some agents decide to represent sellers and landlords exclusively **or** buyers and tenants exclusively.
- **Geography** – In a large market area, it can be difficult to keep track of the specifics on all the properties for sale. Some agents may choose to define a "region" that includes certain streets, subdivisions or collections of neighborhoods.

End of Page

6 . Review

Other areas of specialization include:

- **Transactions** – Documents for many types of transactions are unique to that particular transaction. Within an agency, one agent could become a specialist in leases and

subleases, another in exchanges, another in options, and yet another in commercial sales.

- **Business type** – A broker or agent could choose to focus exclusively on one type of business client; for example, hospital clients or fast food restaurants.

End of Page

7 . Review

General economic principles:

Supply and Demand

Activity in our economy revolves around the production, distribution and sale of goods (*the supply*) in order to satisfy the needs of consumers (*the demand*). When supplies are low, the price for a product is high. When supplies increase *and the demand is low*, the price decreases.

Price and Value

The *price* of an item is the **actual money paid for that item**. However the economic principle that underlies price is *value*.

End of Page

8 . Review

Productivity and Costs

All suppliers incur costs or expenses in producing and delivering goods or services to the market. This includes the costs associated with materials, supplies, labor, management and overhead.

These costs play a part in the ever-changing dynamics of supply, demand and value. Suppliers must make their production process as efficient as possible, while minimizing the cost. They must also keep the prices competitive enough to stay in business. This can be a delicate juggling act.

Market Interaction

In a market economy, the primary interactions between supply, demand and price are:

- if supply increases relative to demand, price decreases
- if supply decreases relative to demand, price increases
- if demand increases relative to supply, price increases
- if demand decreases relative to supply, price decreases

Market Equilibrium

According to this principle, market demand moves to meet supply, and supply moves to meet demand. If there is an extreme shortage of an item for which there is normally a strong

demand, suppliers will rush to increase production to close the gap. If inventories of an item are very high, suppliers will stop production until the oversupply has been depleted.

Similarly, if the price of an item far exceeds its cost, new suppliers will enter the market with lower prices. If the price of an item is far less than its perceived value, either consumers will bid up the price or the perceived value will decline.

End of Page

9 . Review

Some aspects of real estate make it different from other goods and services.

- Land has special value because it is scarce.
- Every piece of property is unlike any other piece. Therefore, it is distinctive in both appeal and value.
- If demand in a geographical area drops, the supply (property) cannot be moved to a high demand area.
- Property cannot be easily and quickly exchanged for cash. Buyers must be diligent in searching for and finding the "right" piece of property.
- Real estate cannot respond quickly to changes in demand. If a geographical area is experiencing high demand, new homes can be constructed only at a certain pace, which may not meet the demand in a timely manner. Conversely if demand in an area slows, sellers are put in a "wait and see" mode.
- Properties are at the mercy of the local economy. If the economy picks up, sales increase. If it slows, sales decrease.

End of Page

10 . Review

The amount of real estate available for sale or lease in a geographical area at any particular time is the *supply*. The amount of property sought after for purchase or lease in that area at that time is the *demand*.

In addition to demand, certain factors have an influence on supply.

- Labor and development costs
- Financing
- The community's overall plan
- Government regulations

In addition to supply, other factors influencing demand include:

- Employment availability (**the most important factor**)
- Quality of life
- Neighborhood environment
- Amenities of the property or residence
- Access to services such as shopping, schools, hospitals, etc.

End of Page

11 . Review

National financial trends have an important influence on real estate market conditions.

When the national economy is in a **recession**, supply and demand usually improve for a **buyer**.

On the other hand, when the economy is **expanding**, conditions generally move in favor of the **seller**.

Even though the national economy affects the supply and demand in the real estate market, the economic makeup of the local area is more important.

End of Page

12 . Review

The Pennsylvania Real Estate Commission was established by the General Assembly of the Commonwealth of Pennsylvania under the *Real Estate Licensing and Registration Act*.

This act gives the Commission a number of duties and responsibilities. The Commission has the power to:

- Issue licenses and registration certificates.
- Approve real estate schools and course curriculums.
- Conduct examinations for license applicants.
- Promulgate regulations. *
- Administer and enforce the laws and regulations.
- Set all fees required under the Act.
- Establish requirements for continuing education.
- Make reports to legislative committees regarding complaints received and budget requirements.

*These regulations are called the *Professional and Vocational Standards*. The Standards are issued in Chapter 35, Title 49 under the Pennsylvania Code.

End of Page

13 . Review

The Department of State acts through the Commissioner of Professional Occupational Affairs. The Department is the **administrative wing** of the Real Estate Commission.

It is the duty of the Department to:

- Arrange for professional testing services to write and administer examinations on behalf of the Commission with the Commission's guidance and approval.
- Issue license and registration certificates to any person who complies with the *Real Estate Licensing and Registration Act*.
- Collect fees for licenses and certificates.

End of Page

14 . Review

Pennsylvania currently has several licenses that can be issued by the Department of State.

- Broker
- Broker of Record
- Salesperson
- Cemetery Broker
- Cemetery Salesperson
- Builder/Owner Salesperson
- Rental Listing Referral Agent
- Campground Membership Salesperson
- Time-Share Salesperson

End of Page

15 . Review

Any nonresident of Pennsylvania who meets the equivalent experience requirements and other standards and qualifications the commission requires can obtain a Pennsylvania license.

A nonresident can obtain one of two types of license:

- Reciprocal
- Standard

End of Page

16 . Review

Pennsylvania will issue **reciprocal** licenses to applicants from states that have agreed to credit Pennsylvania's requirements without imposing further education, experience or examination requirements on Pennsylvania applicants wanting licenses in their state.

Licensees with reciprocal licenses will not be required to complete any **additional** education, experience or examination requirements in Pennsylvania, as long as they keep their licenses in their home state up-to-date.

Applicants who do not qualify for a reciprocal license may obtain a **standard** license. Applicants who are currently licensed or who have been licensed in another state within the last five years need only **pass the state portion of the Pennsylvania** examination and be of good moral character to be issued a license.

End of Page

17 . Review

All of the following activities require a real estate license in Pennsylvania, when being performed for another person or entity.

- Promoting oneself as a real estate consultant, counselor or house finder.
- Listing real estate for sale.
- Selling or offering to sell real estate.*
- Buying or offering to buy real estate.*
- Dealing in the exchange of real estate.*
- Leasing or renting real estate.*
- Offering to lease or rent real estate or placing a sign on a property.
- Negotiating a loan on real estate.
- Collecting rent for the use of real estate.
- Offering or attempting to collect rent for the use of real estate.
- Managing property.
- Performing a **Comparative Market Analysis**.

*This does not apply to an individual or an entity whose main purpose is advertising, promotion or public relations work.

End of Page

18 . Review

Antitrust laws are designed to maintain and preserve business competition.

The Sherman Antitrust Act of 1890 is the principal federal statute that covers competition.

The Sherman Antitrust Act prohibits:

- Price Fixing
- Group Boycotts
- Market Allocation
- Tie-in Arrangements

Individual violators of the Sherman Act can be fined up to \$350,000 and sentenced to up to 3 years in federal prison for each offense; corporations can be fined up to \$10 million for each offense.

End of Page

19 . Review

The protected classes of the Federal Fair Housing Act are:

- Race
- Religion
- Color
- National origin
- Sex
- Ancestry
- Handicap
- Familial status

End of Page

20 . Review

The Pennsylvania Human Relations Act (PHRA) is a state law dealing with discrimination in housing and employment.

Even though this law is considered *substantially equivalent* to the Federal Fair Housing Act, it differs in some significant ways.

- Pennsylvania considers **age** (40 years or older) as a protected class.
- The term "handicap" is described more specifically as:
 - Handicap or disability (used interchangeably)
 - Use of a guide or support animal because of deafness or blindness
 - A handler or trainer of guide or support animals
 - The handicap or disability of an individual with whom the person has a relationship or association

In addition, unlike the federal law, Pennsylvania law applies to housing accommodations **and to commercial property**. This means that persons wanting to buy or lease commercial property have the same protections as those who want residential housing.

End of Page

21 . Review

Fair Housing Law prohibits a number of activities in real estate. These activities include:

- Refusing to sell, rent or negotiate with any person.
- Changing terms, conditions or services for different individuals as a means of discrimination.
- Stating or advertising that the property is restricted.
- Telling persons that a property is not for sale or rent when it is.
- Making a profit by inducing owners to sell by telling them that persons of a protected class are moving into a neighborhood (known as **blockbusting** or **panic peddling**).

- Channeling homebuyers toward or away from homes in certain neighborhoods (also called **steering**).
- Giving different terms for loans to buy or repair or denying a loan altogether.
- Restricting the number of loans in certain areas of a community (also known as **redlining**).
- Denying membership in any multiple listing service (MLS) or any broker's organization.

End of Page

22 . Review

The Fair Housing laws allow for exemptions in some areas. However, please note **there are absolutely no exemptions, exceptions or excuses for racial discrimination.**

The Federal exemptions to the 1968-88 laws are listed below. *However, many of the exemptions to the federal law do not apply under Pennsylvania law.*

- The sale or rental of a single family home by an owner is exempt if the owner does not own more than three homes at one time, does not use discriminatory advertising and does not use a real estate agent.
This law does not apply under Pennsylvania law.
- Rental of units in an owner-occupied, one-to-four family dwelling is exempt.

In Pennsylvania, this exemption applies only to the rental of an owner-occupied two-unit dwelling; an owner-occupied rooming house with a common entrance and a shared bathroom; or the rental of a unit in a single-sex dormitory.

End of Page

23 . Review

These exemptions also apply.

- Religious organizations may restrict housing to members of the same religious organization. Non-profit religious organizations can add a surcharge to the sale or rental of a property to a person that does not belong to their religious group, as long as the membership in the group is not limited by race, color or national origin.
- Private clubs may restrict rental or occupancy of its dwellings to members only, *as long as the dwellings are not commercially operated.* However, the club may not discriminate in its membership requirements.
- Senior citizen housing is exempt if the residents are at least 62 years old or 80% of the units are occupied by at least one person 55 or older.

As we mentioned earlier, exemptions that are outlined in the federal Fair Housing Act have limited application in Pennsylvania.

In Pennsylvania, **the federal exemptions apply only to:**

- Federally-assisted, privately-owned housing

- Government housing

End of Page

24 . Review

If a licensee violates the Pennsylvania Human Relations Act (PHRA), he or she will also be in violation of Section 604 of the Real Estate Licensing and Registration Act.

Section 604 prohibits:

- Accepting listings that discriminate against protected classes in the sale or rental of property.
- Giving false information for purposes of discrimination against protected classes.
- Making distinctions in the locations of housing or dates of availability for purposes of discrimination against protected classes.

The State Real Estate Commission can take disciplinary action against a licensee who violates the PHRA, in addition to any action the Human Relations Commission might take.

End of Page

25 . Review

The federal Fair Housing Act is administered by the Office of Fair Housing and Equal Opportunity under the direction of the secretary of Housing and Urban Development (HUD).

Any person who believes he or she has been discriminated against may file a complaint with HUD within **one (1) year** of the alleged act. HUD can also initiate a complaint on its own.

In addition to or instead of filing a complaint with HUD, a person may file a suit in a state or federal court **within two (2) years** of the alleged violation.

If the court finds that discrimination has occurred, the person filing the complaint may be entitled to

- Injunctive relief
- Actual damages
- There is no cap on punitive damages

End of Page

26 . Review

Broker-Salesperson Relationships

A salesperson is licensed to perform transactions **on behalf of** his or her licensed broker. The broker is ultimately responsible for the actions of his or her affiliated licensees. *Therefore,*

the salespersons must perform all activities in the name of the broker.

A salesperson may engage in only those activities assigned by the broker. And the salesperson may receive compensation for performed activities **ONLY from the employing broker.**

Since the salesperson is acting as the agent of the broker, he or she has no authority to make contracts with or accept compensation from any other party – including another broker, the buyer, the seller or a referral agency.

End of Page

27 . Review

A broker can hire a salesperson as:

- An employee
- An independent contractor

The difference between the two is an issue of **control**, as established by income tax laws.

An **employee** works under the supervision and control of the broker.

An **independent contractor** is hired to perform certain acts, but the broker cannot control *how* the salesperson performs those acts.

End of Page

28 . Review

If a broker hires a salesperson as an **employee**, he or she can require the salesperson to follow rules regarding such things as:

- Working hours
- Office duty
- Meetings
- Dress code

In addition, the broker **must withhold** income tax, Social Security tax and Medicare tax from the salesperson's wages.

In Pennsylvania, the broker is also required to:

- Withhold state income tax.
- Pay unemployment.
- Pay worker's compensation.

Salespersons who are employees could receive health insurance or profit-sharing benefits from the broker.

Most real estate assistants, both licensed and unlicensed, are considered employees for income tax purposes.

End of Page

29 . Review

On the other hand, if a salesperson is hired as an **independent contractor**, it is quite a different story.

A broker can tell the independent contractor *what* to do, but now *how* to do it. In this case, the broker cannot dictate working hours or require the salesperson to have office duty at specific times or attend meetings.

A salesperson operating as an independent contractor must pay his or her own income tax, Social Security tax and Medicare tax. In addition, the salesperson cannot receive anything from the broker that would make it look like he or she is an employee, such as health insurance or a pension plan.

Most licensees are independent contractors.

End of Page

30 . Review

Regardless of a salesperson's status as employee or independent contractor, the broker should enter into a written agreement* with each salesperson.

The agreement should clearly:

- State each person's responsibilities to the other.
- Clarify the licensee's compensation program.
- Define who will pay for incidental business expenses.

End of Page

31 . Review

Compensation Agreements

The compensation the broker will receive is usually spelled out in one of the following:

- Listing agreement
- Buyer's agency agreement
- Management agreement

This commission can be computed in any of these ways.

- Percentage of the transaction amount
- Flat fee
- Fee for service
- Hourly rate

In Pennsylvania, the law dictates that the broker and the client determine commission rates through **negotiation**.

End of Page

32 . Review

A broker will earn compensation when that broker has actually completed the work he or she was hired to perform.

Commission is usually **paid** after the transaction has been consummated. However, the commission is **earned** when the following activities have occurred.

- The broker has produced a ready, willing and able buyer.
- The buyer has signed an offer to purchase.
- The seller has accepted the offer.
- Both buyer and seller have received signed copies of the agreement.

The commission is paid to the broker who was the **procuring cause** of the sale – in other words, the broker who *took action to start or to cause a chain of events that resulted in the sale*. It's important to understand that merely being involved in a transaction, such as showing a home, can be different from being the procuring cause.

End of Page

33 . Review

Salesperson Compensation

The broker can choose to pay the salesperson a salary or a percentage share of the commission from the transaction.

Many companies have a payment plan that is "graduated." In this type of program, an agent may start out at a lower percentage payment, but then graduate to higher percentage rates as his or her production increases.

Other companies have a 100% commission plan. In this situation, the agent pays a monthly fee to the company to cover the costs of things like office space, telephones, office equipment and supervision. In return, the agent receives 100% of the commission from any sales he or she negotiates. Most often in these programs, the agent is responsible for the costs of advertising and promotion.

End of Page

34 . Review

In most cases, a real estate transaction is completed by cooperating brokers. Each broker will receive an agreed upon share (percentage) of the compensation. These shares can be referred to as the listing side commission and the selling side commission.

A licensee who lists a home for sale will receive a share of the employing broker's commission on the listing side. This share will be based on the compensation agreement this agent has with the employing broker.

A licensee who sells a listing will receive a share of the employing broker's commission on the selling side. This share will also be based on the compensation agreement this agent has with the employing broker.

If a licensee lists *and* sells a property, he or she will receive a share of both the listing and selling side commissions.

End of Page

35 . Review

An **agency relationship** is created when a person (buyer or seller, landlord or tenant), also called the *principal*, delegates to another person, called the *agent*, the right to act on his or her behalf in business transactions with third parties.

Several principles govern that relationship.

- Both parties must consent to the relationship.
- Both parties must agree to form the relationship.
- The relationship is *fiduciary* – meaning the agent owes certain duties to the principal.

According to Pennsylvania Licensing Law, an agency relationship is defined as "*A relationship whereby the broker or licensees in the employ of the broker act as fiduciaries for a consumer of real estate services by the express authority of the consumer of real estate services.*"

If the principal in the relationship is the seller, then the broker (or the salesperson representing the broker) is the **seller's agent**. Conversely, if the principal in the relationship is the buyer, the broker (or the salesperson representing the broker) is the **buyer's agent**.

End of Page

36 . Review

Three types of agency relationships exist.

Express agency

This is a written agreement in which the parties involved formally express the intention to form an agency relationship and they outline the terms and conditions of that agreement.

A *listing agreement* is the common form of express written agency agreement between a seller and a broker, authorizing the broker to find a ready, willing and able buyer for the property.

A *buyer's agency agreement* is the common form of express written agency agreement between a buyer and a broker, authorizing the broker to find a suitable property to purchase or rent.

Note: In Pennsylvania, *all listing and employment contracts must be in writing.*

End of Page

37 . Review

Implied Agency

A written agreement is not necessary to create an agency relationship – the relationship can be implied.

This relationship is formed when the actions of the parties indicate that they have mutually consented to an agency. In fact, the persons involved may not have consciously planned to form an agency relationship. However, their actions may *unintentionally, inadvertently or accidentally* form the relationship.

Example, you are a consumer looking to purchase a property. We corresponded by email, and you are flying in today to look at properties to purchase. We have not agreed to anything in writing, but I am going to pick you up at the airport, and show you 5 pre-selected homes. You agree, and I pick you up and proceed to show you all of the properties. Nothing is discussed regarding buyer representation during our time together. At the end of the day I say to you, "Let me know if you are interested in buying any of these properties and by the way don't work with anyone else because I am your agent." You say, "I will let you know once I discuss the properties with my wife, and I will not work with anyone else because you are my agent." We have created an "Implied" agency which by the way is illegal because the law says that the agency relationship must be in writing.

Ostensible Agency

This agency relationship arises *by the actions of the parties involved*, rather than by a written agreement.

NOTE: An agency relationship is based on authorization and mutual consent. **It is not based on compensation.**

Ostensible agency example would be best described as a situation wherein an owner knows that a broker/salesperson is showing the owner's property to a prospective buyer without authority to do so. Unless the owner takes steps to stop such unauthorized showings, the law considers that third parties have just cause to believe the broker to be the owner's agent. Therefore, the owner could become liable for certain acts of the broker/salesperson. On the surface an agency appears to exist, and is caused by the actions of the parties as stated below.

End of Page

38 . Review

Constructive Notice

Constructive notice is the legal presumption that information is available and can be obtained through due diligence (care and activity). This is also referred to as *legal notice*.

Actual Notice

Actual notice means that not only is the information available, but someone has been given the information and actually knows it.

Imputed notice

This means that what an agent knows is binding on the principal because of the agency relationship they have entered into.

End of Page

39 . Review

Client versus Customer

An agent is a person who is empowered by contract to represent the interests of a **client**, also known as the *principal*. The principal could be a seller, a buyer, a landlord or a tenant. The agent represents the principal in dealings with third parties, who are known as **customers**.

Fiduciary Duties

The duties that the agent owes his or her principal are:

- **Care** - The law expects an agent to do his or her job with a reasonable degree of **care, skill and diligence**. Since the principal hires an agent because of his or her expertise in the field, the principal expects the agent to use that expertise on the principal's behalf.
- **Obedience** - This requires that the agent act in good faith and *obey the principal's directions* as outlined in the contract, **as long as they are legal**.
- **Accountability** - An agent must be able to *account for all monies*, documents and other property he or she receives from the principal.
- **Loyalty** - The duty of loyalty requires the agent to *place the client's interests above those of all others*, including his or her own. **Confidentiality** about the principal's affairs is an important aspect of loyalty.
- **Disclosure or Notice** - An agent is bound to *inform the client of all facts that might affect the client's interests in the transaction*. This includes both the facts that the agent **knows** and those that the agent **should have known**.

These are often referred to by the acronym **COALD** or **COALN**.

End of Page

40 . Review

Single Agency

In a single agency relationship, the agent can represent only one party in a single transaction. He or she owes fiduciary duties to *one principal*. All other parties to the transaction receive services as customers, not clients.

Subagency

When a broker appoints another broker to help perform activities on the client's behalf, a subagency agreement is formed. The subagent is not employed by the listing broker, but *acts for or cooperates with* the listing broker in the transaction.

End of Page

41 . Review

Dual Agency

Dual agency means representing both parties in the same transaction – the seller and the buyer or the landlord and the tenant. Pennsylvania law allows dual agency **only if the buyer and seller are informed of the situation and give their written consent**.

Designated Agency

Designated agency means that a broker, with the written consent of the principal, may designate one or more licensees to act exclusively as the agent of the seller or landlord, and designate one or more licensees to act exclusively as the agent of the buyer or tenant in the same transaction. The broker is still a dual agent in the transaction, but, by designating separate agents for each principal, the individual client's interests are protected.

End of Page

42 . Review

The Pennsylvania license law also allows a licensee to act as what's called a **transaction licensee**.

A transaction licensee is not an agent for either party. When serving in this capacity, a licensee:

- Must advise the consumer that he or she is not acting as an agent or advocate for the consumer and should not be provided with confidential information.
- Owes the additional duty of *limited* confidentiality and may not disclose the following information:
 - The seller or landlord will accept a price that is less than the asking listing price.
 - The buyer or tenant will pay a price greater than the price submitted in a written offer.
 - The seller or landlord or the buyer or tenant will agree to financing terms other than those offered.

- What the motivating factors are for any party buying, selling, or leasing the property
- Any confidential information about the other party, unless disclosure of such information is required by law, statute, rules or regulations or failure to disclose such information would constitute fraud or dishonest dealing

End of Page

43 . Review

State law requires that licensees disclose information to consumers about the kinds of relationships they can form. These disclosures serve to remove any confusion about whom the agent is working for and give the consumer a clear understanding of the services that licensees provide to clients and customers.

In Pennsylvania, licensees are required to give a document called the *Consumer Notice* to any party **before** he or she signs any kind of agency agreement or sales contract.

The licensee must provide this *Consumer Notice* at the initial interview with the party and most certainly before the licensee actually performs any services.

End of Page

44 . Review

Types of housing accommodations include:

- Single family residence
- Apartment building or complex
- Condominium
- Cooperative
- Mobile home
- Modular home
- Time-share
- Planned unit development
- Converted-use property
- Retirement community
- High-rise development

End of Page

45 . Review

With all the housing options available, it would seem that everyone should own or be able to own property. But the desire to own is only one small part of the picture. The most important factor for a prospective property owner is the answer to the following question:

"Can I afford to own property?"

First time homebuyers must:

- Have enough money for a down payment.
- Have money for closing costs.
- Be eligible for a mortgage loan.

A number of programs do exist that can assist first-time home buyers. Some loan programs offer lower closing costs or deferred interest or principal payments.

End of Page

46 . Review

One of the benefits of homeownership is in the area of taxes.

When filing their income taxes, homeowners can take deductions against their gross income for:

- The interest portion of each monthly mortgage payment made during the tax year
- Ad valorem real estate taxes (not including any interest or penalties they paid on overdue taxes)
- Certain loan origination fees
- Discount points
- Loan prepayment penalties

End of Page

47 . Review

Over the years since 1997, the Federal government has enacted federal tax reforms that have changed the importance of tax considerations for many homeowners.

Previously, homeowners were required to pay a substantial **capital gains tax** on the profit from the sale of their principal residence. However, the law now allows a **married couple to exclude the first \$500,000 of profit** from the sale of their home and a *single taxpayer to exclude \$250,000*.

Homeowners are entitled to use this exemption time after time, **as long as the homeowners have occupied the property as their primary residence for at least two of the last five years.**

In addition, in an attempt to make it easier to obtain down payments, the government will allow first-time homebuyers to make penalty-free withdrawals from their tax-deferred individual retirement funds (IRAs). However, there is a lifetime limit of \$10,000 on such a withdrawal.

End of Page

48 . Review

Once an owner has purchased property, it's important for him or her to protect that investment. In addition, lenders often require a homeowner to purchase insurance, so that their interest in the property is also protected.

The most common type of insurance is **homeowner's insurance**. There are basic insurance policies as well as others that offer broader coverage.

End of Page

49 . Review

Coinurance Clause

Most homeowner's policies have what's called a *coinsurance clause*. This clause requires that the homeowner have insurance that is **equal to 80% of the home's replacement value**. This does not include the price of the land.

If an owner has this type of policy, he or she could make a claim for the *full cost* of the repair or replacement without deduction for depreciation.

If the owner does not carry this type of insurance – he or she carries less than the 80% figure – any claim will be handled in either of these two ways.

- The loss will be settled for actual cash value.
- The loss will be prorated.

End of Page

50 . Review

Private companies offer flood insurance that is subsidized by the federal government. This insurance protects the owner from damage caused by floods or tidal waves.

Lenders that are regulated by the government require insurance on any property located within areas identified by the Federal Emergency Management Agency (FEMA) as being flood prone. The government requires the lenders to initiate, maintain and renew flood insurance.

Flood insurance is not included in a basic homeowner's policy.

End of Page

51 . Review

Mine Subsidence

In a commonly used coal mining technique, workers created rooms in a checkerboard or grid pattern, leaving pillars of un-mined coal to support the mine roof and the surface. Over time, perhaps years, decades, or even centuries, there is sinking or shifting of the ground surface resulting from collapse in the underground mine. When the roof of a subsurface mine collapses, it causes the ground above to sink or subside.

Pennsylvania has a serious problem with abandoned mines.

Standard homeowner's insurance does not cover damage caused by subsiding mines. To help with this problem, the Mine Subsidence Insurance (MSI) Fund, administered by the Department of Environmental Protection, provides insurance to those who own property above abandoned underground coal or clay mines. DEP will investigate to see if insurance is warranted and will issue an inexpensive policy if they find there is potential for damage. If a building has been damaged, DEP will conduct an inspection to determine the extent and nature of the damage.

Property owners can receive \$150,000 worth of coverage for about \$135 annually. Coverage is available from \$5,000 to \$500,000 up to the replacement value of the home plus 10% to cover losses to the appurtenances.

This nonprofit insurance fund, established in 1961, is sustained by its policyholders' premiums and has no waiting period for coverage to begin.

End of Page

52 . Review

The **listing agreement** is the contract that creates an agency relationship between the broker and the principal (seller) authorizing the broker to offer the seller's property for sale and to solicit purchase offers to submit to the seller.

There are three primary types of listing agreements:

- Exclusive-Right-To-Sell
- Exclusive Agency
- Open Listing

End of Page

53 . Review

The most widely used agreement is the **exclusive-right-to-sell** listing. Under this arrangement, the broker has the *exclusive right* to market the property for a specified period of time. If the property sells while the broker has the listing, the seller must pay the agreed upon commission, *regardless of who actually procured the buyer (who was the procuring cause)*. This means that even if the seller himself finds the buyer with no help from the broker, the seller still owes the broker the commission.

An **exclusive agency** agreement gives one broker the exclusive right to market and sell the property, while the owner retains the right to find a buyer and sell the property without owing

the broker a commission. The seller must pay a commission only if the home is sold by the broker or an authorized agent or subagent of the broker.

End of Page

54 . Review

An **open listing** is a non-exclusive contract. This type of listing gives the seller the right to engage any number of brokers as agents. With an open listing, all contracted brokers can market the property at the same time. But **only the one broker who brings the ready, willing and able buyer will receive the commission.**

Note: According to Pennsylvania license law, an open listing may be oral *if the broker gives the seller a written memorandum stating the terms of the agreement.*

A **net listing** is not technically a type of listing agreement. In a net listing, an owner sets a minimum amount that he wants to receive from the sale of the property and lets the broker have as commission any amount above the set minimum.

Net listings are generally viewed as unprofessional and they are illegal in many states.

End of Page

55 . Review

Pennsylvania licensing law requires a written agreement between the broker and a consumer if the consumer will be paying the broker a fee. The agreement must outline the services the broker will perform for compensation and state the compensation amount.

Note: This rule does not prohibit a licensee from performing services before such an agreement is signed, but **he or she is not entitled to receive a fee or commission without a signed agreement.**

End of Page

56 . Review

The licensing law requires all written agreements to contain the following statements. These rules apply to agreements with both buyers and sellers.

- The broker's fee and the duration of the contract have been determined as a result of negotiations between the broker and the consumer.
- A description of the nature and extent of the broker's services that will be provided to the consumer and the fees the broker will charge.
- An explanation of the possibility that the broker or any licensee employed by the broker may provide services to more than one consumer in a single transaction with an explanation of the duties that may be owed to each party and the fees the broker could receive for those services.

- A description of the broker's policies regarding cooperation with subagents and buyer agents or listing agents (depending on whether the consumer is a buyer or seller) and the potential for disclosed dual agency.
- A notification that the broker will hold any money received by him or her in connection with a sale until the sale is consummated or terminated.
- An explanation of the Real Estate Recovery Fund and a telephone number where the consumer can receive further information about the fund.
- A statement regarding any possible conflicts of interest and informing the consumer the licensee has a continuing duty to disclose any conflicts in a timely manner.

End of Page

57 . Review

In addition to the general rules for written agreements listed on the previous screen, these rules apply specifically to **listing agreements**.

An exclusive listing agreement (whether exclusive-right-to-sell or exclusive agency) must contain:

- The sale or lease price
- The commission, fees or other compensation expected on the sale or lease price
- The duration of the agreement
- In the case of an exclusive-right-to-sell agreement, **a statement in bold print** that the broker earns a commission on the sale of the property during the listing period regardless of who makes the sale, including the owner.

In the case of an exclusive-right-to-lease agreement, **a statement in bold print** that the broker earns a commission on the lease of the property during the listing period regardless of who makes it happen, including the lessor.

End of Page

58 . Review

An exclusive listing agreement **may not contain**

- A listing period exceeding 1 year
- An automatic renewal clause
- A cancellation notice to terminate the agreement at the end of the listing period on the date set as the ending date in the agreement
- Authority of the broker to execute a signed agreement of sale or lease for the owner or lessor
- An option by the broker to purchase the listed property
- Authority of the broker to confess judgment against the owner or lessor for the Commission in the event of a sale or lease

Note: Some listing agreements contain what is referred to as a "*broker protection clause*." This clause says that the owner will compensate the broker if, within a certain number of days after the listing expires, the owner sells the property to someone the broker "introduced"

to the property during the listing period. This clause typically does not apply if the owner re-lists the property with the original or another broker.

End of Page

59 . Review

Pennsylvania law also requires that brokers follow these rules regarding listings.

- A broker may act for more than one party in a transaction ONLY with the knowledge and consent in writing of all the parties involved.
- A broker may place a "for sale" or "for rent" sign on or advertise a property ONLY with the written consent of the owner or the owner's authorized agent.
- A broker must voluntarily furnish a copy of the listing, sale, lease, or other contract relevant to the transaction to all persons signing the contract *at the time of execution*.
- The listing contract must specify a **definite termination date** that is not subject to prior notice.
- A broker may not induce any party to an existing contract to break that contract for the purpose of substituting a new contract, when the substitution is motivated by the broker's personal gain.
- A broker must abide by the Pennsylvania Human Relations Act by refusing to accept a listing if the seller wants or expects the broker to discriminate illegally against a prospective purchaser.

End of Page

60 . Review

A broker must also follow these Pennsylvania rules.

- Must not solicit the sale of a property from an owner so frequently that it becomes clear **harassment** of that owner.
- May not make frequent efforts to sell a property in a particular neighborhood because of fear of declining real estate values when the fear is not based on facts relating to the intrinsic value of the real estate itself. (**Panic selling**)
- A broker must provide the *Consumer Notice* to any person who wants to sell or purchase residential or commercial real estate.
- A broker who sells or leases his own real estate must disclose that he or she is a real estate licensee when advertising the property, *unless the property is listed with a real estate company*.

End of Page

61 . Review

Once a broker and a seller have a listing agreement in place, each has a responsibility to fulfill the terms of the agreement. However, at some point in time the listing agreement will

end.

There are several reasons a listing could terminate.

- The agreement is fulfilled. (performance)
- The listing period stated in the agreement expires.
- Both parties mutually agree to cancel the listing.
- The broker doesn't perform his or her duties as stated. (abandonment)
- The seller or the broker breaches the terms of the listing agreement.
- Either the broker or the seller dies or becomes incapacitated.
- The title is involuntarily transferred through bankruptcy, foreclosure or condemnation.
- The property is destroyed by fire, storm or other disaster.

End of Page

62 . Review

Pennsylvania law has several rules regarding using names in advertising.

- Brokerage companies must advertise themselves to the public *only under the business name designated on their license*.
- Individual licensees who wish to use and advertise nicknames (for example, Jack v. John or Margaret v. Peggy) must include the names on their licenses or renewal applications.
- An advertisement by a licensee must have the business name and telephone number of the employing broker. The names and telephone numbers must be of equal size.

End of Page

63 . Review

Any advertisement for a real estate offering that uses lotteries or contests or that offers prizes, certificates, gifts or free lots must contain

- A description of each prize, certificate, gift or lot
- The prerequisites for receiving each prize, certificate, gift or lot
- A limitation on the number of prizes, certificates, gifts or lots offered
- The fair market value of each prize, certificate, gift or lot
 - If the advertisement is in print, the statement of fair market value must be in the same size type as the description of the prize, certificate, gift or lot.
- The odds of winning or receiving each prize, certificate, gift or lot.
 - If the advertisement is in print, the statement of odds must be the same size type as the description of the item and must appear immediately adjacent to the description.

End of Page

64 . Review

In 1996, Pennsylvania adopted a property disclosure law called the **Real Estate Seller Disclosure Act**. This law requires any seller of residential real estate to disclose to the buyer any and all material defects.

The seller is obligated to disclose any structural, mechanical or other conditions that a prospective buyer would need to know to make an informed decision.

Although the *seller* is responsible for completing the disclosure statement, the *licensee* is responsible for letting the seller know about this duty and for providing an appropriate form for the seller to use.

An agent should advise the seller to be truthful when filling out the disclosure so as to avoid any possible future litigation that could result from misrepresenting the facts.

Any prospective purchaser must receive a signed and dated disclosure on the property **before he or she signs an offer to purchase**.

End of Page

65 . Review

The two common methods that can help determine a reasonable asking price for a property are:

- Comparative market analysis (CMA) -- also referred to as a competitive market analysis
- Appraisal

When doing a **comparative market analysis**, an agent does a comparison of properties that are similar to the seller's property in location, size, style, age and amenities. The agent looks at

- Prices of recently sold property
- Prices of properties currently on the market
- Properties that were listed and did not sell

The agent then compares the researched properties with the seller's property and makes adjustments in the sales price based on any significant differences in the property.

When the agent has completed a comparison of several properties against the seller's property, he or she can come up with a range of value to present to the seller that will assist the seller in arriving at a reasonable and appropriate listing price.

End of Page

66 . Review

The **listing contract** is a legal document. Its specifics may vary depending on the actual form used. But all listing agreements tend to require very similar types of information, since the

kinds of things that arise in real estate transactions tend to be similar from one area to another.

Here is a list of some items most typically covered in a listing contract.

- Type of listing agreement (exclusive-right-to-sell, exclusive agency or open)
- Name of broker and firm
- Names of all the parties to the contract
- Listing price
- Broker's authority
- Broker's responsibilities
- Property address and description (may include the legal description)
- Broker's compensation (including the statement that the compensation amount was arrived at through negotiation)

End of Page

67 . Review

Both the broker and the seller have the power to cancel a listing agreement at any time. However, they don't always have the **right** to cancel it. Depending on the circumstances, a broker or seller may terminate the contract but still be liable to the other party for damages.

If a seller cancels the listing *after the broker has earned the commission*, the seller **is obligated to pay the commission**.

If the broker *has not performed fully* prior to the termination of the contract, the seller **could be liable for at least the broker's actual costs and possibly the commission as well**. The seller's liability will depend on the type of listing agreement the parties had and whether or not the property sold during the term of the canceled contract.

If the broker terminates the listing, the **seller may be able to sue the broker for money damages**.

End of Page

68 . Review

A **Multiple Listing Service (MLS)** is an *organization of member brokers who share listing information with one another*. The contractual obligations between the brokers of the MLS organization can vary a great deal. However, most organizations state that the commission will be *divided between the listing and selling broker when the property sells*. The terms of that distribution can vary from broker to broker. The MLS usually requires that a broker register a new listing within a specified amount of time.

The MLS service usually distributes the information about the listings in print publications and online. Today's electronic technology has made it possible for brokers to receive the most recent updates on a property, such as a change in price or a change in status from active to sold or withdrawn.

End of Page

69 . Review

Once a broker has secured a listing, he or she must do everything possible to bring that information to the market.

Develop and Follow a Marketing Plan

It's vital for a licensee to have a **written plan** for how he or she will market each of the listings. Some activities will be the same from one listing's marketing plan to another, but other tasks will be unique to the particular property based on its specific characteristics.

The marketing approach will consist of:

- Traditional Tools
 - For-Sale Sign
 - Rider Strips
 - Lockbox
 - Photos
 - Talking House
 - Classified Ads
 - Flyers
- E-Tools
 - Multiple Listing Service (MLS)
 - Your Internet Site
 - Other Internet Sites
 - Virtual Tours
 - Video Tours
- Ancillary Tools
 - Home Tours
 - Canvass Letter
 - Agent Open House
 - Public Open House

End of Page

70 . Review

The word "**client**" is interchangeable with the word "principal" and the word "**customer**" is used interchangeably with the word "consumer."

Pennsylvania law defines these terms as follows.

- *Consumer*—An individual or entity who is the recipient of any real estate service.
- *Principal*—A consumer who has entered into an agency relationship with a broker or another licensee employed by the broker.

There is a difference between the level of service a licensee provides a customer and what an agent provides to a client.

End of Page

71 . Review

An agent owes fiduciary responsibilities to the client. Because of the agency relationship and the agent's level of expertise in real estate, the agent can offer counsel and advice that the client can rely on when making decisions.

On the other hand, a licensee gives only factual information to a customer. The licensee must deal with the customer honestly and fairly, but does not offer any advice.

An agent works **for** the client (principal) and **with** a customer.

End of Page

72 . Review

Buyer agency is a relationship where the licensee, upon entering into a written agreement, works only for the buyer (or tenant).

A buyer's agent owes the client additional duties.

- Loyalty to the buyer by acting in the buyer's best interest.
- Confidentiality, except that a licensee **must** disclose known material defects about the property.
- Continuous and good faith effort to find a property for the buyer, except while the buyer is subject to an existing contract.
- Disclosure to other parties in the transaction that the licensee is the buyer's agent.

A buyer's agent may be paid fees, which may include a percentage of the purchase price. Even if the seller pays the fees, the buyer's agent will represent the interests of the buyer.

End of Page

73 . Review

There are three types of **buyer agency agreements**.

Exclusive Buyer Agency -- With this type of agreement, the buyer is bound to compensate the broker whenever the buyer purchases the type of property described in the agreement. The broker gets the commission regardless of who locates the property – broker, buyer or another licensee.

Exclusive Agency Buyer Agency -- This is also an exclusive contract with one broker. However, in this type of agreement the broker gets a commission *ONLY if he or she locates*

the property that the buyer purchases. If the buyer locates the property, he or she owes no commission to the broker.

Nonexclusive Buyer Agency -- This agreement allows the buyer to enter into other *agreements with multiple brokers*. The buyer must pay a commission to only the one broker who locates the property the buyer purchases. If the buyer finds his or her own property, no commission is owed to any of the brokers.

End of Page

74 . Review

According to Pennsylvania law, a seller's agent may compensate other brokers as **subagents** if the seller agrees in writing. Subagents have the same duties and obligations to the seller as the seller's agent.

Sometimes there is confusion between the terms subagent and cooperating broker. A **subagent and a cooperating broker are not the same**. A cooperating broker may be either of the following:

- A subagent acting on behalf of the seller.
- A *buyer's agent who is cooperating with the listing broker* to bring the buyer-client and the seller together to complete a transaction. In this case, the relationship is *single agency* – the selling broker works for the buyer and the listing broker works for the seller.

End of Page

75 . Review

In Pennsylvania, licensees are required to give a document called the *Consumer Notice* to any party **before** he or she signs a buyer's agency agreement. This document describes the different types of agency relationships available to consumers and explains the services licensees provide to clients and customers.

According to Pennsylvania law, the licensee must **provide this Consumer Notice at the initial interview with the party**, if that interview occurs in person, and most certainly before the licensee actually performs any services.

Also according to Pennsylvania law,

- Licensees must keep a copy of the signed/refused acknowledgement **for 6 months** and provide the consumer a copy of the entire disclosure summary.
- The Disclosure Summary must be entitled "Consumer Notice" and must be in the exact format specified by the Commission and available from the Commission office upon request by phone, fax or internet.

Once a prospective buyer has read and understood the *Consumer Notice*, he or she will be in a better position to give **informed consent** to an agreement. Informed consent is essential to

a valid contract. A person must have all the facts and be able to act without undue influence when they enter into a contract with an agent.

End of Page

76 . Review

When signing an agency agreement, it's important for the buyer to clearly understand the services the licensee will be providing and the benefits of those services. Two important duties a licensee owes to clients are **loyalty** and **confidentiality**.

In addition, a licensee does the following:

- Gives Advice - While a seller's agent working with a buyer will use methods specifically designed to get the buyer to sign the contract, a buyer's agent will take the time to advise his or her buyers about the pros and cons of any property they see.
- Assists With Negotiations - A good agent can be a buyer's best advantage during the negotiation process. Some buyers really thrive on being involved in the offer-counteroffer situation. But most buyers are uncomfortable with the process; especially if it involves a home they really want and have already formed some emotional attachment to.
- Searches For Homes - A buyer's agent will do everything that he or she can to find a suitable home for the buyer he or she represents. In most cases, this entails searching for all the homes that are listed in the area, both with the agent's own firm and with all other brokers who belong to the local multiple listing service (MLS). A buyer's agent could also search for homes that are:
 - For sale by owner
 - Open listings
 - Foreclosures
 - In probate

End of Page

77 . Review

If a licensee's misrepresentation of the facts leads a buyer to sign a purchase contract, the contract could be voided. In addition, the agent could lose the commission and even be held liable for damages.

A person's informed consent could be violated through:

- Fraud
- Misrepresentation

End of Page

78 . Review

Fraud can be *active* or *passive*.

Active fraud is an *intentional misrepresentation* of a material fact for the purpose of gaining an unfair or dishonest advantage over another person. This results in an injury to the person who is relying on the information.

Passive fraud is an *intentional nondisclosure* of a material fact. This can happen if a person intentionally fails to disclose a fact or actively attempts to hide the fact.

End of Page

79 . Review

Intentional Misrepresentation

An agent may intentionally defraud a buyer by misrepresenting or concealing facts. While it is acceptable to promote the features of a property to a buyer or the virtues of a buyer to a seller, it is a fine line that divides promotion from misrepresentation. Silent misrepresentation, which is intentionally failing to reveal a material fact, is just as fraudulent as a false statement.

Negligent Misrepresentation

This is an unintentional misstatement or omission. *Negligence is defined as the failure to use ordinary or reasonable care in a situation.* Negligent misrepresentation is usually the result of an agent's giving information carelessly or failing to verify a fact before passing it to the buyer.

An agent does not have to intentionally misrepresent a fact. The agent would be liable if he or she **knows** or **should have known** that the fact he or she is sharing is false.

End of Page

80 . Review

Licensees are seen as experts in the field of real estate by their clients. Clients tend to believe that everything an agent tells them is a fact. But agents *do give their opinions* on property.

An agent can offer an opinion as long as he or she does so with no intention to be deceptive. The agent should clearly identify to the client what is fact and what is just an opinion.

Exaggerated or superlative comments about a property's benefits are called ***puffing***. For example, the statement, "This home has the most efficient floor plan of any of the homes in this neighborhood," is puffing.

The test for whether a statement is puffing or misrepresentation is based on whether a reasonable person would have relied on the statement to make a purchasing decision.

End of Page

81 . Review

The buyer and seller reach agreement through a contract process. The document they use in the process is called an **agreement of sale**. The parties use this document to agree on such items as

- Purchase price
- Deposit or escrow money
- Closing date
- Personal property to be included or excluded from the sale
- Financing
- Inspections
- Any contingencies with their associated dates

The licensees play a role in the process by advocating for their respective clients and negotiating the most favorable terms for that client.

End of Page

82 . Review

Pennsylvania law requires that licensees verify that all disclosure requirements have been satisfied **before** a buyer and seller begin their negotiations.

These requirements include

- *Consumer Notice*
- Disclosure of agency relationships
- Seller's property disclosure
- Estimated statements of cost and return

End of Page

83 . Review

The expenses involved in a transaction play a major role in a buyer's determining how much to offer for a property and a seller's determining how much he or she can accept for the property.

Before the parties execute an agreement of sale, the brokers involved in the transaction must provide each party with *a written estimate of the reasonably foreseeable expenses that the party may be expected to pay*. These expenses include, but are not limited to:

- The broker's commission
- The mortgage payments and financing costs
- Taxes and assessments
- Settlement expenses

These cost estimates must be as accurate as anyone could reasonably expect from a person who has knowledge of and experience in real estate sales.

End of Page

84 . Review

Many real estate boards have preprinted contracts that licensees can use when preparing an agreement. The law allows licensees to use these forms, **but they must be filled out correctly**. Many times the preprinted language on a form does not exactly meet the needs of one or the other of the clients. If licensees choose to alter the language on the form or draft another paragraph to include in the contract, they must be extremely careful that the language they use does not have the potential to cause injury to a client or liability for themselves.

In addition, changes to the preprinted forms are usually initialed and dated in the margin when the contract is executed.

In Pennsylvania, licensees can fill out preprinted forms such as leases and agreements of sale, **as long as they do not charge a fee for completing the forms**.

End of Page

85 . Review

Licensees are not authorized to practice law. The consequences of giving legal advice to a client are severe.

- Criminal prosecution, punishable by up to one year in prison and a \$2,500 fine
- Disciplinary action by the Real Estate Commission which could result in a fine, license suspension or revocation
- Lawsuit filed by the injured party which could result in monetary damages award

Both buyers and sellers *should have the opportunity to get independent legal counsel before signing any contract*. A licensee should **never give any kind of legal advice or try to interpret provisions in the agreement of sale unless he or she is also a licensed attorney**.

End of Page

86 . Review

When a prospective buyer prepares and signs a document wanting to purchase a property, the document is usually referred to as an *offer to purchase*. This is the first step in the negotiation process.

If and when the offer is accepted and signed by the seller, it becomes the *agreement of sale*. This agreement of sale is a **legally binding contract between the buyer and the seller**.

The licensees who represent the buyer and seller owe fiduciary duties to their respective clients throughout the entire negotiation process, **but they are not parties to the contract.**

The acceptance of the contract is usually the final step in the negotiation process; however, there may be several steps *between the offer and the acceptance* in the form of *counteroffers*.

End of Page

87 . Review

After a buyer submits an offer, if the seller chooses to make a change to any of the terms the buyer is proposing, in effect the **seller has rejected the offer and created a counteroffer**.

The buyer can then choose to accept the counteroffer as is or reject it totally. Alternatively, the buyer can choose to continue the negotiation process by making another counteroffer.

Any change to the last offer made creates another counteroffer. This process will continue until one of two things happen:

- The buyer and seller reach an agreement.
- Either the buyer or the seller walks away from the negotiation.

Note: An offer or a counteroffer **may be withdrawn at any time before it has been accepted**, even if the person making the offer or counteroffer has agreed to keep it open for a set time period.

Once one of the parties agrees to an offer or counteroffer exactly as written and signs the document, **the offer is accepted and a legal contract is formed**. The licensee must then communicate the acceptance to his or her client. **Each party must receive a copy of the signed contract.**

End of Page

88 . Review

Pennsylvania law says that all contracts, commitments and agreements between a broker and a principal or a consumer who is required to pay a fee commission or other valuable consideration must be in writing and contain certain information.

One reason for this is that a contract must be in writing to be enforceable. The **statute of frauds** requires that contracts for the sale of real estate be in writing and signed by the seller to be **enforceable in a court of law**. And the *parol evidence rule* states that a *written contract takes precedence over oral agreements or promises*.

The written agreement of sale:

- Establishes the buyer's right to enforce the interest in the property by court action if necessary.
- Obligates the buyer to complete the sale as agreed upon.
- Obligates the seller to convey the property.

End of Page

89 . Review

Usually when a buyer makes an offer, he or she accompanies the offer with a deposit that is referred to as **earnest money**. The earnest money deposit is a good faith gesture that shows the seller that the buyer is serious about the offer and intends to carry out the terms of the contract.

The earnest money belongs to the buyer until the offer is accepted. If the offer is not accepted, the money is returned to the buyer. Once the seller accepts the offer, the buyer is no longer entitled to the earnest money. The seller is also not entitled to it until the transaction closes. But even though the broker is the "keeper" of the funds, under no circumstances does the money ever belong to him or her. The broker must deposit the funds into an escrow account.

End of Page

90 . Review

Pennsylvania has several rules regarding escrow accounts.

- A broker must deposit the earnest money he or she receives into an escrow account **in a federally or state-insured bank** or depository. The funds must be held until the transaction is consummated or it results in a non-disputed termination.
- A broker is not required to hold in escrow rents that he receives as a property manager for a lessor. Instead, the broker should deposit those monies into a rental management account that is separate from the escrow account and general business accounts.
- If a broker receives earnest money under an installment land purchase agreement, the transaction will be considered consummated when the buyer has recorded the agreement.

End of Page

91 . Review

These Pennsylvania rules also apply.

- If a broker receives earnest money under an agreement of sale involving cemetery property, the transaction will be considered consummated when the buyer receives a copy of the agreement of sale.
- If a broker receives a security deposit under a lease agreement, the broker will have the duty to pay back the deposit when the tenancy ends.

If a sale or a change in the property management contract occurs during the term of the tenancy, the broker may transfer the security deposit from his own escrow account to the escrow account of the lessor or the lessor's broker. He must notify in writing all tenants from

whom he received deposits telling them the name and address of the bank where the deposits will be held and the amount of the deposits.

Important Note: A broker's escrow duty **may not be waived or altered** by an agreement between the:

- Parties to the transaction
- Broker and the parties
- Broker and other brokers who may be involved in the transaction

End of Page

92 . Review

Pennsylvania law also has rules about who assumes responsibility for the earnest money in a co-brokerage transaction.

- If the buyer gives the deposit to the listing broker rather than the selling broker, the listing broker will handle the escrow.
- If the buyer gives the deposit to the selling broker knowing that the selling broker will deliver the deposit to the listing broker, the listing broker will handle the escrow. The buyer must acknowledge in writing, prior to signing the agreement of sale, that the selling broker provided the following information:
 - The name of the listing broker.
 - That the selling broker's acceptance of the buyer's deposit is on behalf of the listing broker as subagent for the listing broker.
 - That the listing broker is a licensed real estate broker who is required to hold the deposit in escrow.
 - That the listing broker will be designated as payee, if the buyer's deposit is in the form of a check.
- If the buyer gives the deposit to the selling broker without the buyer having notice described above, the selling broker will handle the escrow.

End of Page

93 . Review

Pennsylvania law has set deadlines for when a broker must deposit earnest money into an escrow account.

A broker must deposit the earnest money into an escrow account by **the end of the next business day following its receipt** in the real estate office where the escrow records are maintained.

If the broker receives a check for the earnest money with *an offer to purchase*, the broker may, if both parties agree in writing, refrain from depositing the money into an escrow account **until the offer is accepted**. The broker must deposit the check into an escrow account **within 1 business day of acceptance of the offer**.

End of Page

94 . Review

According to Section 604 of the Pennsylvania Code, these rules also apply to earnest money and escrow accounts.

- A broker must account for all earnest money deposits in the full amount at the time a transaction is consummated or terminated.
- Every salesperson and associate broker who receives an earnest money deposit must give the deposit to the broker promptly.
- A broker must not commingle the principal's money or other property with his own.
- A broker must never allow any advance payment of funds to be deposited in his or her business or personal account or to be commingled with any funds he or she may have on deposit.
- Every broker must keep records of all funds he or she deposits.
- A broker may deposit money into his or her escrow account to cover any service charges the bank may assess to this account.

End of Page

95 . Review

An actual agreement of sale form has several sections. Although the layout of the forms may vary, the information is generally the same. A typical agreement of sale contains the following information.

- Date of the agreement
- Names of the parties
- Description of the property (could be a legal description)
- Sale price
- Payment method (including earnest money deposit and financing conditions)
- Dates for closing and possession
- Provisions for:
 - Title search and insurance
 - Prorating taxes, insurance and utilities
 - Damage or destruction before closing
 - Default
 - Contingencies
- Signatures

End of Page

96 . Review

The agreement of sale can contain one or more **contingencies**. *A contingency is a condition that must be satisfied before the agreement is fully enforceable.* A contingency contains three aspects:

1. The actions that will satisfy the contingency.

2. The time frame in which the actions must be performed.
3. Who will pay the costs, if any.

There are three common types of contingencies.

- Mortgage -- A mortgage contingency is designed to protect the buyer's earnest money until he or she has a loan commitment from the lending institution.
- Inspection -- This contingency allows the buyer time to get and study inspections of the property.
- Property sale -- This contingency states that the purchase is contingent on the sale of the buyer's home.

End of Page

97 . Review

Pennsylvania also requires the agreement to contain these statements.

- The zoning classification of the property, except if the property is zoned solely or primarily for single-family dwellings.
- A statement identifying the capacity in which the broker is involved in the transaction and whether the broker or any affiliated licensees have provided services to another party in the transaction.
- A provision that the broker will hold all earnest money payments in an escrow account pending consummation or termination of the sale.
- A statement describing the Real Estate Recovery Fund with a Commission telephone number that a consumer can call for further information.
- A statement that access to a public road may require issuance of a highway occupancy permit from the Department of Transportation.
- In the case of an agreement of sale for the purchase of a time share or campground membership, a statement regarding the purchaser's right to cancel the contract.

In addition, the agreement of sale must also include a lead-based paint disclosure for property built prior to 1978 and a sewage facilities disclosure.

End of Page

98 . Review

If either party violates the terms of a contact, the contract may be terminated. This situation is known as a **breach of contract** – a violation of any of the terms or conditions without a legal excuse.

Buyer Remedies

One remedy available to a buyer is a suit for **specific performance**. In this suit, the buyer would ask the court to force the seller to complete the sale and convey the property as agreed.

Another remedy would be a **suit for damages**. In this case the seller would be asked to pay for any costs or hardships that the buyer suffered because of the seller's breach.

End of Page

99 . Review

Seller Remedies

If a buyer breaches the contract, the seller can sue for damages or for the purchase price. If the suit is for purchase price, it is essentially a suit for **specific performance**. In this case the seller will produce the deed and ask the court to require the buyer to pay the purchase price.

If an agreement has a *liquidated damages clause*, the remedies are limited.

- If the buyer defaults, this clause allows the seller to keep the earnest money and any other money received from the buyer as his or her only remedy.
- If the seller defaults, the buyer's remedy may be the return of the earnest money and any other money paid to the seller.

If an injured party wants to bring suit against the defaulting party, there is a set time period when that may be done. This is called the *statute of limitations*. In Pennsylvania, the statute of limitations is **four years from the date of the contract breach**. Once that time period expires, all rights are lost.

End of Page

100 . Review

Real estate sale agreements can be discharged or terminated for several other reasons.

Partial Performance - In some cases, the parties may agree that the performance of an action is "close enough" and may agree to move on to completion with some minor actions left unperformed.

Impossibility of Performance - In rare cases, a party may discover that a required action can't be accomplished legally. In this situation, the parties may choose to move forward to complete the sale or terminate it.

Mutual Agreement - Sometimes the parties will both agree to cancel. If this happens, any money that has been exchanged will be returned to the appropriate party.

Operation of Law - This is a term that describes how rights belong to a person simply by applying established rules of law to a particular transaction without any action by the person. For example, discovery of fraud could terminate a contract. Altering the contract without the written consent of all the parties involved would also terminate the contract by operation of law.

End of Page

101 . Review

A **mortgage** is a financing instrument that creates a lien against a property. The *lender who gives the money* is the **mortgagee**, and the **borrower who gives the mortgage** is the **mortgagor**.

The borrower retains the rights of ownership (title) to the property while the property becomes encumbered by the lien.

Whenever a potential homebuyer borrows money for the purpose of buying a home, he or she will be required to sign a document that describes the amount of money borrowed, the terms under which it will be repaid, and any conditions that relate to either the borrowing of the money, or the consequences in event of default. This document is a **promissory note** (usually referred to as a "**note**" or a "**bond**") and establishes legal evidence of the debt incurred.

A mortgage always needs a note to be legally valid. In the event of **default** by the purchaser, the lender has the right to bring legal action through the courts to satisfy the debt. This is called *a judicial foreclosure* since it must be ordered by the court. Proceeds from the foreclosure sale are used to repay the remaining debt on the mortgage loan. We'll talk more about foreclosures in a few minutes.

End of Page

102 . Review

Lenders often charge other fees when the borrower gets a loan. The borrower could pay all or some of these charges.

- Loan origination fees - This fee is typically **1 percent of the loan amount**, although it could be higher. It covers the lender's cost for generating the loan.
- Points - This is a one-time service charge to the borrower for making the loan. Points represent prepaid interest and the lender charges them to get additional income on the loan. Points are paid at closing and are usually equal to **1 percent of the loan amount**.
- Discount Points - *Discount points are a means of raising the effective interest rate of the loan.* The rule of thumb is 1/8 percent for each discount point.

End of Page

103 . Review

Several types of loan repayment plans exist. The most common are:

- Straight (Interest-only)
- Amortized
- Adjustable-rate
- Balloon payment

End of Page

104 . Review

Straight Loan

Also known as an interest-only loan, the monthly payments are allocated only to interest. No principal is paid off. At the end of the term, the borrower must be able to pay off the entire principal amount or get another loan.

Amortized Loan

With this loan payment plan, a borrower makes a periodic (usually monthly) payment of principal plus interest. These payments result in the loan being paid off gradually over time. At the end of the loan term, the full amount of the principal and all of the interest is totally paid off and the balance is zero.

With a *fully amortized loan*, the borrower has the **same payment amount every month**. With a *straight amortized loan*, the borrower pays a **different amount with each payment**. A fixed amount goes to the principal with each payment.

End of Page

105 . Review

Adjustable-Rate Mortgage

With an adjustable-rate mortgage (ARM), the interest rate is linked to an economic **index**. The loan starts at one rate of interest, but then it fluctuates up or down over the life of the loan as the index changes. The loan agreement describes how the interest rate will change and when.

Adjustable-rate mortgages (ARMs) became very popular in the 1980's when interest rates were at an all-time high. When 30-year fixed rates are in a reasonable range, the adjustable rate does not appeal to most borrowers. For a borrower that only intends to own the property for a short period of time, an ARM may be a good option. The components of an ARM are:

- Index
- Margin
- Calculated rate
- Initial rate
- Adjustment period
- Interest rate caps
- Payment cap
- Negative amortization cap
- Conversion option
- Step rate or buy down
- Mortgage payment adjustment period

Balloon Payment Loan

A balloon payment loan is a long-term loan that has one large final payment due when the loan matures. A balloon loan often has the advantage of very low interest payments. The major problem with a balloon payment loan is that the borrower has to come up with a large sum of money at the end of the term.

End of Page

106 . Review

Two other less common repayment plans are the *growing equity mortgage* and the *reverse annuity mortgage*.

Growing Equity Mortgage (GEM)

The growing equity mortgage is a fixed-rate loan in which payments increase by a predetermined amount each year, reducing the outstanding balance of the loan. This accelerated payment plan allows repayment of the loan much more quickly.

There are some *advantages* to growing equity mortgages.

- The low up-front payments may make it easier for first-time home buyers to qualify for and afford a loan.
- A GEM is usually paid off faster than a traditional fixed-rate mortgage.

The major *disadvantage* of a growing equity mortgage is that the payment continues to go up, regardless of the borrower's income or financial position. This can lead to potential problems for the borrower being able to meet future mortgage payments.

Reverse Annuity Mortgage (RAM)

This type of loan is quite different from the others. With a reverse annuity mortgage, *the lender is making payments to the borrower*. This system allows older property owners to receive regular monthly payments from the equity in their paid-off property without having to sell. The borrower pays a fixed rate of interest and then repays the loan either when the home sells or from the borrower's estate upon his or her death.

To qualify for most reverse mortgages, the borrower must be at least 62 and live in the home. The proceeds of a reverse mortgage (without other features, like an annuity) are generally tax-free, and many reverse mortgages have no income restrictions.

End of Page

107 . Review

The **conventional loan** is the **most common** type of loan and is generally viewed as the most secure. Most conventional loans require the borrower to make a down payment of 20% or more, making the loan 80% or less of the property's sale price.

Conventional loans are typically *uninsured*. The mortgage itself provides the only security for the loan. To protect its interests, the lender relies on the appraisal of the property and the borrower's ability to repay the loan, as indicated by the borrower's credit reports.

When writing conventional loans, many lenders follow the underwriting standards that are provided by Freddie Mac and Fannie Mae, so that they can sell their loans in the secondary mortgage market. We'll be discussing Freddie Mac, Fannie Mae and the secondary market later in this chapter.

A borrower can get a conventional loan with a lower down payment by **insuring** the loan through a **private mortgage insurance program (PMI)**.

End of Page

108 . Review

The following items are important to know about **FHA loans**.

- FHA loans can be either fixed-rate 10- to 30-year loans or one-year-adjustable loans.
- The borrower must have cash for a down payment and closing costs. These items cannot be added to the sales price and become part of the loan repayment.
- The maximum loan fee is 1 percent of the loan amount and is typically paid by the buyer.
- As of 2006, the borrower must pay two insurance premiums. The first is the "upfront" **Mortgage Insurance Premium (MIP)** which is a percentage of the loan amount. The borrower can pay this one-time premium at closing or the charge could be financed with the loan. This premium could be paid by some other party, such as the seller. The second premium, called **Mutual Mortgage Insurance (MMI)** is a monthly premium that is paid with the monthly principal, interest, taxes and insurance payment. This is often referred to as PITI + MMI. MMI premiums may be dropped when the remaining loan balance is 80 percent loan-to-value ratio or less.
- FHA requires that the monthly amounts the borrower pays toward taxes, insurance and MMI be deposited into an escrow or impound account.
- The lender can charge points and either the borrower or the seller (or both) can pay them.

End of Page

109 . Review

- Loans are assumable, but the rules for assumptions vary depending upon when the loan originated, the type of property, and the specific FHA program under which the original loan was given.
- The mortgaged real estate must be appraised by an approved FHA appraiser. These appraisals are called "conditional commitments" and are good for six months on existing property and one year on new construction.
- There is no maximum on what the purchase price of the property can be. The borrower can pay more than the appraisal; but the loan will be based on the appraisal amount.
- The borrower must occupy the property.
- FHA requires evidence from a recognized structural pest inspection company that an existing property has no pest infestation.
- The property must meet the FHA standards for type and construction. FHA also has standards about the quality of the neighborhood. These loans are available for one-to-four family residences and some condominium units.
- FHA loans are also available to help residents or investors repair or rehabilitate single-family properties.
- There are no prepayment penalties on FHA loans on one-to-four-family residences. However, the borrower must give 30 days' written notice to pay a loan in full before it is due.

- There is no due-on-sale clause. Original terms of the loan stay the same and cannot change because of a sale.

End of Page

110 . Review

A **VA-guaranteed loan** is yet another alternative for a little or no down-payment loan. These loans are available to *eligible* veterans and their spouses. Unlike an FHA loan, which is *insured*, a VA loan is **guaranteed**.

A VA loan can be used to:

- Buy a home, including a townhouse or condominium unit in a VA-approved project.
- Build a home.
- Simultaneously purchase and improve a home.
- Improve a home by installing energy-related features.
- Refinance an existing home loan up to 90 percent of the VA-established reasonable value or refinance an existing VA loan to reduce the interest rate.
- Buy a manufactured home and/or lot.

End of Page

111 . Review

The following are important facts to know about VA loans.

- In most cases, no down payment is required.
- The loan maximum may be up to 100 percent of the VA-established reasonable value of the property. However, due to secondary market requirements, loans generally may not exceed \$203,000. (**Note:** This amount changes periodically.)
- Maximum loan terms are 30 years for one-to-four family homes and 40 years for farms.
- The VA guarantees both fixed-rate and adjustable rate loans.
- Interest rates are negotiable between the lender and the borrower.
- There is no monthly mortgage insurance premium to pay.
- Buyer's closing costs are limited to reasonable costs plus no more than a 1% loan origination fee.
- Any discount points charged can be paid by either the veteran or the seller.
- The loan can be prepaid without a penalty.
- The VA charges a funding fee, which can be paid at closing or financed with the loan.

End of Page

112 . Review

VA loans are also *assumable*. If the loan was made prior to March 1, 1998, the loans are assumable for a small processing fee. If the loan was made after March 1, 1998, the VA must approve the assumption agreement.

For *all* assumed loans, the original veteran borrower is still liable for the repayment of the loan unless the VA approves a ***release of liability***.

A veteran must apply to the VA for a **certificate of eligibility** to determine his or her eligible status and to determine the amount of the loan the VA will guarantee.

The VA also requires an appraisal of the property the veteran is seeking to purchase. The VA then issues a **certificate of reasonable value (CVR)** on the property.

End of Page

113 . Review

In addition to conventional, FHA and VA loans, other types of financing are also available. These are the most common.

Purchase Money Mortgage -- A technique in which the buyer *borrows from the seller* in addition to the lender.

Installment Land Sales Contract - The buyer does not receive legal title until the final payment is made.

Lease-Purchase -- A tenant enters into two agreements simultaneously: an agreement to purchase and a lease.

Lease Option -- A clause in a lease that gives the tenant the right to purchase the property under specific conditions.

End of Page

114 . Review

Second Mortgage -- An additional loan on a property with a primary mortgage already in place.

Blanket Mortgage -- A loan that covers more than one piece of property.

Buydown -- A financing technique used to reduce the monthly payment for a borrower during the initial years of the loan.

Construction Loan -- A loan to build new homes or construct improvements to a property.

Wraparound Loan -- Allows a borrower who has an existing loan to get another loan from a second lender without paying off the first loan.

Package Loan -- A loan that includes all the personal property and appliances that are installed on the property.

End of Page

115 . Review

Other less common types of financing are available to prospective buyers in the marketplace. Among these are:

- Open-End Loan -- An expandable loan which gives a borrower a limit up to which he or she may borrow.
- Sale and Leaseback -- The owner of the real estate sells the property and then *leases it back* from the buyer.
- Bridge Loan -- A short-term loan that covers the period between the end of one loan and the beginning of another.
- Home Equity Loan -- Allows owners to borrow against the equity they have built up in their home.
- Grant Programs -- Provide buyers with a "gift" of money to use toward their down payment or closing costs and which never has to be paid back.

End of Page

116 . Review

The **primary mortgage market** is made up of lenders who originate loans. They make the money available directly to borrowers.

The primary mortgage market is made of many different types of lenders.

- Savings associations
- Commercial banks
- Credit unions
- Insurance companies
- Investment groups
- Mortgage bankers
- Mortgage brokers

NOTE: In Pennsylvania, mortgage bankers and mortgage brokers must be licensed and conduct business under the provisions of the *Mortgage Bankers and Brokers and Consumer Equity Protection Act*. The Department of Banking issues the licenses and regulates the activities of the licensees. However, the Real Estate Commission has some limited authority when these licensees are also licensed real estate brokers or salespersons.

End of Page

117 . Review

Loans originated in the primary mortgage market can be bought, sold or traded in the **secondary mortgage market**. Primary lenders sell their notes to generate more money to make more loans.

The secondary mortgage market consists of holding warehouse agencies that purchase a number of mortgage loans and assemble them into one or more packages of loans for resale to investors.

The major participants in the secondary mortgage market include:

- Federal National Mortgage Association (FNMA or Fannie Mae)
- Government National Mortgage Association (GNMA or Ginnie Mae)
- Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac)

End of Page

118 . Review

The Federal National Mortgage Association, (FNMA) or **Fannie Mae**, is a government-sponsored agency that is organized as a private corporation. Fannie Mae:

- Buys conventional, FHA and VA loans.
- Buys a pool or block of mortgages from a lender in exchange for mortgage-backed securities.
- Sells mortgage-backed securities.
- Guarantees payment of all interest and principal on mortgage-backed securities.

End of Page

119 . Review

Government National Mortgage Association, (GNMA) or **Ginnie Mae**, is a division of the Department of Housing and Urban Development (HUD). Ginnie Mae:

- Administers special assistance programs.
- Helps Fannie Mae in its activities.
- Guarantees payment on Fannie Mae's high-risk, low-yield loans, absorbing the difference between the low yield and the current market rates.
- Guarantees securities issued by private entities (banks, mortgage companies, etc.) that are backed by pool of VA and FHA loans.

End of Page

120 . Review

Federal Home Loan Mortgage Corporation, (FHLMC) or **Freddie Mac**, is a federal agency. Freddie Mac:

- Buys and pool mortgages.
- Sells bonds in the open market, using the mortgages as security.
- *Does not guarantee* payment of Freddie Mac mortgages.

End of Page

121 . Review

The process of obtaining a loan first begins when the borrower fills out an **application** and gives it to the lender to evaluate. Because so many lenders are interested in selling off their loans to the secondary market, many lenders use the standardized Fannie Mae and Freddie Mac forms. These forms are referred to as ***uniform procedures***.

When evaluating a loan application, the lender is assessing the risk of granting the loan to the buyer. This evaluation process is called **underwriting**.

The lender must evaluate the borrower's ability to repay the loan. This is called *qualifying the buyer*. Qualifying the buyer involves assessing the buyer's income, net.

End of Page

122 . Review

The lender must also *qualify the property* the buyer wants to purchase. When qualifying a property, the lender will consider:

- Type of property (residential, commercial, agricultural)
- Location
- Area zoning
- Value range
- Neighborhood
- Actual age/Effective age/Remaining economic life
- Condition (repairs and predication)
- Special clearances (code compliance, well and septic certifications etc.)
- Overall marketability

Once the underwriting process is complete and the applicant has qualified, the lender will give the applicant a written notice (**loan commitment**) that specifies the terms of the agreement the lender is willing to grant.

End of Page

123 . Review

The mortgage loan is made up of two parts:

- Debt
- Security for the debt

When a borrower receives a mortgage loan, he or she must sign two documents: the *note* and the *mortgage*. The borrower becomes the **mortgagor** and the lender becomes the **mortgagee**.

Note: The note is the buyer's *promise to repay* the loan according to the terms. All of the buyer's assets become available to claims by creditors. The note the buyer signs is a *promissory note*, which states the amount of the debt, the time and method of payment, the interest rate and other loan terms.

Mortgage --The mortgage creates *the lien on the property*. The property becomes available to claim by the lender. The mortgage document gives the creditor the right to foreclose if necessary.

End of Page

124 . Review

The federal government plays an active role in regulating the practices of mortgage lenders. The laws that apply to mortgage lending include:

- Truth in Lending and Regulation Z
- Equal Credit Opportunity Act (ECOA)
- Real Estate Settlement Procedures Act (RESPA)
- Fair Housing Laws

End of Page

125 . Review

The *Truth in Lending Act* is implemented by *Regulation Z*. This law requires lenders to disclose to buyers the true cost of obtaining credit, so that borrowers can compare the costs of various lenders.

Regulation Z applies to all *loans that are secured by a residence*. It does not apply to:

- Commercial loans
- Agricultural loans over \$25,000

Penalties

The penalty for violation of Regulation Z is twice the amount of the finance charge or a minimum of \$100, up to a maximum of \$1,000. The violator could also be liable for court costs, attorney fees and any actual damages.

Willful violation of regulation Z is a misdemeanor that is punishable by a fine of up to \$5,000 or one year in prison, or both.

End of Page

126 . Review

The Equal Credit Opportunity Act (ECOA) prohibits lenders from discriminating against applicants on the basis of:

- Race
- Color
- Religion
- National origin
- Sex
- Marital status
- Age
- Dependency on public assistance

ECOA expects a lender to base lending decisions on an individual's income, net worth, job stability and credit rating. Any applicant who will rely on income from child support for repayment of the loan must reveal that income to the lender.

Lenders are also required to inform an applicant who was rejected of the reasons for the denial. This notice must be in writing and given within 30 days.

End of Page

127 . Review

Fair Housing Laws

Redlining is defined as the practice of refusing to make a mortgage loan or restricting the number of loans in an area for reasons other than the economic qualifications of the applicant.

Federal Fair Housing laws prohibit discrimination in mortgage lending for lenders in both the primary and secondary mortgage markets. A lender can refuse to extend a loan only on sound **economic** grounds.

The passage of the *Home Mortgage Disclosure Act* is an effort to offset redlining practices. All mortgage lenders with assets exceeding \$10 million who have one or more offices in a certain geographic location must send reports to the government annually, detailing all mortgage loans the institution has given or purchased. The reports must be broken down by census tract, which enables the government to detect any redlining patterns.

End of Page

128 . Review

The Real Estate Settlement Procedures Act (RESPA) attempts to standardize settlement practices and to ensure that both buyers and sellers understand the costs involved in closing the transaction.

RESPA applies to residential real estate purchases that will be financed by first mortgage loans.

RESPA prohibits lenders from paying kickbacks and unearned fees to parties who may have referred the borrower to the lender. This includes real estate agents who may have referred the buyer to the lender.

End of Page

129 . Review

An **appraisal** is an *opinion or estimate* of the value of a property. It's important to stress that an appraisal is just an estimation based on a collection of evidence and not an actual determination of the value of a property.

Before giving a loan, mortgage lenders want to know the value of the property that will be the collateral for that loan so they can be sure the value is enough to cover the loan.

It can be said that the **market value** of a property is the highest price a buyer is willing to pay and the lowest price the seller will accept.

The **market price** of a property is the actual sales price.

End of Page

130 . Review

Many principles influence the value of property.

Anticipation -- The benefits a buyer expects to receive over the period of time he or she has the property.

Assemblage -- When two adjacent pieces of property are joined together, the value of the one larger parcel may be greater than the value of the two separately.

Change -- Both market conditions and a property's physical condition change constantly over time.

Conformity -- This principle says that a property is at its highest value when it conforms with and fits into its surroundings.

Competition -- This principle holds that when several businesses of a similar type are close to one another, together they may make more money than they would have individually.

End of Page

131 . Review

Contribution -- This is what the market recognizes as the change in value an improvement makes to a property, rather than what that improvement actually cost.

Diminishing Return -- This condition is a result of continuing to add improvements to a property when those improvements will have no effect on increasing the value of the property.

Highest and Best Use -- According to this principle, every property has a single use which produces the greatest income and return.

Progression and Regression -- This principle holds that a property is affected by the surrounding properties.

Substitution -- A buyer will not pay more for a home than what he or she would pay for another home that is equally attractive and available.

Supply and Demand -- The value of a property depends on how many properties are available in an area, property prices, number of prospective buyers and price buyers are willing to pay.

End of Page

132 . Review

Appraisers typically use three approaches to estimating the value of property.

- Sales Comparison Approach
- Cost Approach
- Income Capitalization Approach

Appraisers typically use all three approaches to value the subject property as a way to guard against errors and establish a "range" of value. However, each approach tends to give a more reliable estimate for a particular property type.

End of Page

133 . Review

The **sales comparison approach** is based on the principle of substitution, which says that a buyer will not pay more for the subject property than he or she would pay for a property that is similar in characteristics and amenities.

With this approach, the value is determined by comparing the property being appraised with recently sold comparable (equivalent) properties.

Since no two properties are exactly alike, the appraiser must compare the similarities and differences among the properties and then *make adjustments to the sales prices of the*

comparable properties to account for the differences.

The sales comparison approach is deemed to be *the most reliable for appraisals of single-family homes.*

End of Page

134 . Review

The **cost approach** is most reliable for properties that were built recently, since the appraiser can get access to the actual costs of the development and construction. It's also a good approach for special purpose buildings when data on income is not available or there are no comparable sales.

The cost approach attempts to estimate either the property's *replacement cost* or *reproduction cost*.

Reproduction cost is the construction cost at today's prices of producing an **exact duplicate** of the current building, including its improvements and its flaws.

Replacement cost is the construction cost at today's prices of producing a **similar or equivalent** structure. This method is most popular when appraising older buildings with outdated features. Newer materials and techniques can replace the outmoded ones.

End of Page

135 . Review

The cost approach has five steps.

1. Estimate the value of the land as if it were vacant and available for its highest and best use. This step is usually done using the sales comparison approach. (**Note:** Land does not depreciate in value.)
2. Estimate the cost of improvements – either replacement or reproduction cost.
3. Estimate the accrued depreciation that results from physical deterioration, functional obsolescence or economic obsolescence.
4. Subtract the depreciation total from the estimated cost of improvements.
5. Add the land value to the depreciated cost to get the total estimated value of the property.

End of Page

136 . Review

Depreciation refers to a loss in value of a property due to any cause. Depreciation can be **curable** (economically feasible to repair) or **incurable** (not economically feasible to repair). In real estate, depreciation is divided into three classes according to cause:

Physical Deterioration – Decay or disintegration, cracks, settling, structural defects, termite damage

Functional Obsolescence – Within the property lines, outdated plumbing, electrical or heating, outmoded lighting fixtures or architecture

External Obsolescence – Outside the property lines, population changes, neighborhood changes that decrease value, legislative changes (usually incurable)

End of Page

137 . Review

Appraisers most often use the **straight-line method** to estimate accrued depreciation. The straight-line method is also called the **economic age-life method** and assumes that depreciation occurs at a steady rate over the economic life of the property. *This method is primarily useful when estimating depreciation from physical deterioration.*

The economic life is that time period that a building is expected to remain useful for its originally-intended purpose. The cost of the building is divided by the number of years of its economic life, and the result is the annual depreciation amount.

End of Page

138 . Review

Appraisers use the **income approach** to estimate the value of properties that produce income, usually from rent paid on leases. This approach assumes that an investor will purchase a property based on the future income stream the property will produce – the principle of *anticipation*. This approach also assumes that an investor will not pay any more for a property with a certain income than he or she would pay for a similar property with a similar income – the principle of *substitution*.

The downside to this method is that it is often difficult to determine an appropriate capitalization rate and the needed information about income and expenses can be hard to find.

End of Page

139 . Review

The income approach has five steps.

1. Estimate the potential gross income.
2. Estimate the effective gross income.
3. Estimate the net operating income.
4. Select a capitalization rate.
5. Apply the capitalization rate.

End of Page

140 . Review

The **gross rent multiplier** (GRM) and the **gross income multiplier** (GIM) are very similar to the income approach. However, appraisers use these approaches to estimate the value of properties such as single-family homes and duplexes that *could* produce income, but are *not primarily income-producing properties*, such as apartment buildings and office space.

These methods employ the application of a multiplier to the estimated gross income or gross rent of the subject property. In other words, they relate the sales price of the property to its expected income.

End of Page

141 . Review

Reconciliation

If an appraiser uses all three approaches to estimate the value of a property – sales comparison, cost and income -- he or she will likely arrive at three different estimations.

The appraiser must then reconcile the estimates into a **final value estimate**. The best way to do this is to evaluate how appropriate each method is to the particular type of property being appraised and to make decisions about the quality and quantity of the data that was gathered to support each method.

End of Page

142 . Review

In 1989, Congress passed the **Financial Institutions Reform, Recovery and Enforcement Act (FIRREA)**, which, among other things, included provisions regulating appraisal activities.

Title XI of FIRREA says that only competent, properly-supervised, **state-certified** appraisers can conduct appraisals on federally-related transactions.

As a result of these regulations, in 1990, Pennsylvania created the Board of Certified Real Estate Appraisers and passed the Real Estate Appraisers Certification Act.

End of Page

143 . Review

There are three classes of certification under the Real Estate Appraisers Certification Act of 1990.

- A **certified residential appraiser** can do appraisals of residential real property only.
- A **certified general appraiser** can do appraisals of both residential and nonresidential real property.
- A **broker/appraiser** can perform appraisals of real properties valued under \$250,000 that are not federally-related transactions. Brokers who applied by September 3, 1998, were granted this certification. However, after that date any broker who wants to be certified to perform appraisals must apply and meet the current requirements of the certified residential or certified general appraiser.

End of Page

144 . Review

The **closing of the property** is the culminating event in a real estate transaction. Closing is often referred to by another name – settlement – but, by either name, the process is the same.

At the property closing:

- The buyer completes his or her financing arrangements (referred to as *closing the loan*).
- The seller transfers the title.
- Both the buyer and seller pay the necessary taxes, fees and other charges.

End of Page

145 . Review

A seller is required to deliver a **marketable title** at closing. A marketable title is one that is so free of defects that the buyer is certain he or she will not have to defend the title.

In order to deliver a marketable title, the seller must have proof of ownership of the property, also known as **evidence of title**.

Before a lender will agree to lend money on a property, the lender will order a title search to be sure there are no liens on the property. The buyer is responsible for paying the fee for the title search.

End of Page

146 . Review

When the search is completed, the buyer will receive either an **abstract of title** from an attorney or a **title commitment** from a title insurance company.

Either of these documents will give information about any liens, easements, encumbrances, conditions or restrictions that may be attached to the title.

It's critical that **both the buyer and the seller review the abstract before the closing** so that they have an opportunity to resolve any problems.

If there are any encumbrances or liens, the seller will be expected to remove them so that he or she can pass clear title to the buyer.

If the buyer is purchasing title insurance, the title company will not issue a policy until the buyer has taken care of any and all problems that would affect the insurability of the title.

End of Page

147 . Review

The primary attendees at the closing are the:

- Buyer
- Seller
- Closing agent

Others who may attend the closing, but are not required to, are:

- Attorneys for the parties
- Lender representative
- Title company representative

End of Page

148 . Review

Also known as the *settlement agent*, the **closing agent** actually conducts the closing. He or she can be the broker, an attorney, the lender or a title company representative.

The closing agent prepares all the documents that need to be signed at the closing, including the actual settlement statements that show all the debits and credits assigned to the buyer and seller in the transaction.

End of Page

149 . Review

Much of what the **broker** does to facilitate a closing happens during the period between the signing of the agreement of sale and the actual closing date.

Many times the broker is involved in ordering inspections, surveys or appraisals. The broker can also help the buyer find a mortgage lender or help schedule needed repairs to the

property.

NOTE: Brokers and real estate agents have many contacts in the world of lenders, property inspectors, surveys, insurance agents and the like. Often these people offer fees to the brokers and agents to get their referrals.

Caution: Licensees must not recommend specific individuals or companies to their clients. Accepting referral fees could be a violation of state licensing laws and the Real Estate Settlement Procedures Act.

End of Page

150 . Review

As with a broker, much of what the **lender** does relating to the closing happens long before the closing date comes.

The lender is primarily interested in protecting its interest in the property. In order to do that, lenders typically require, at the very least, a title insurance policy and a homeowner's insurance policy. Depending on the individual circumstances, a lender might also ask for a survey and inspections.

Lenders can also require the borrower to maintain an escrow account for property taxes and insurance and, depending on the type of loan being issued, may also require private mortgage insurance.

End of Page

151 . Review

As the primary parties, the buyer and seller have critical roles at the closing. They must verify that each of them has fulfilled the contract terms as stated.

Once this is verified, the mortgage loan is closed and each party pays all the appropriate fees associated with his or her side of the transaction. The buyer pays the purchase price for the property and the seller delivers the title.

Then the parties sign the myriad of documents required to finalize the transaction. Finally, the closing agent will do whatever the local laws require to arrange for the recording of the transaction.

End of Page

152 . Review

After the closing, the broker, or whoever acted as the closing agent, has the task of **reporting the transaction to the IRS**.

The IRS requires the reporting of specific information on certain types of real estate transactions. The information typically includes the names and addresses of both parties, the sale price of the property, the property tax reimbursement amount that was credited to the seller and the seller's SSN. The information is filed on a Form 1099-S and the reporting agent must give a written statement to both buyer and seller showing his or her name as the reporting person and the information being reported on the form.

End of Page

153 . Review

RESPA is of great benefit to consumers during the settlement process. RESPA requires that the parties to certain transactions receive the correct figures pertaining to their closing costs.

RESPA applies to purchases:

- Of residential property -- that is, one-to-four family homes, cooperatives and condominiums
- Involving first or second mortgages
- Financed by a federally-related loan – that is, loans that are insured by a federal agency, those that are insured or guaranteed by VA or FHA, HUD-administered loans, or those that will be sold to Fannie Mae, Freddie Mac or Ginnie Mae

RESPA does not apply to seller-financed loans. It also does not apply to a loan assumption, unless the lender has changed the terms of the assumed loan or charges more than \$50 for the assumption.

End of Page

154 . Review

Effective in October 2015, the real estate industry has new requirements as specified in the TILA/RESPA Integrated Disclosure (TRID) Rule.

According to the TRID rule:

- Lenders must give a copy of the booklet, "Your home loan toolkit" to every person at the time of application for a loan.
- Lenders must provide a *Loan Estimate* of settlement costs at the time of loan application or within three business days of application.
- A *Closing Disclosure*, a form designed to detail all financial particulars of a transaction, must be delivered to the borrower at least three days before closing. The actual time frame is based on the method of delivery. The settlement agent must also provide the seller with the Closing Disclosure, which may be done at consummation.

End of Page

155 . Review

Lenders must use the *Closing Disclosure* form to detail the costs that the buyer and seller will pay at closing.

In addition to the costs payable to the lender, the form also itemizes any costs due to other parties, such as city or county tax assessments, recording fees and attorney's fees.

The creditor/lender is generally responsible for insuring that the Closing Disclosure is delivered to the buyer *no later than three business days* before consummation. The creditor may contract with a settlement agent to provide the Closing Disclosure on behalf of the creditor. The settlement agent must provide the seller with the Closing Disclosure and that may be done at consummation.

End of Page

156 . Review

RESPA specifically **prohibits** any payment or receiving of fees or kickbacks when a service has not been rendered. For example, an insurance company cannot pay a kickback to a real estate agent or to a lender for referring a client to their agency.

Referral fees are strictly forbidden for these services.

- Title search
- Title insurance
- Inspection
- Survey
- Appraisal
- Loan
- Credit report
- Attorney

RESPA permits sharing commissions and the payment of referral fees among cooperating brokers or multiple-listing services.

End of Page

157 . Review

In order for the buyer to know how much money to bring to closing and the seller to know how much he or she will receive at closing, the entries on the settlement statement must be calculated.

The closing agent will subtract the total of the buyer's credits from the total debits and the result will be what the buyer needs to bring to closing. Personal checks are usually not accepted at closing, so the buyer will need to bring a certified check or cashier's check.

Similarly, the agent will subtract the seller's total debits from the total credits to arrive at what the seller will receive at closing.

End of Page

158 . Review

Buyer expenses usually include:

- Mortgage recording fees
- Documentary Stamp tax
- Intangible taxes on the mortgage
- Title search and insurance
- Appraisal fees
- Credit fees
- Survey
- Loan origination
- Attorney fees
- Homeowner's insurance
- Reserves deposited with the lender, such as insurance, taxes, assessments
- Private Mortgage Insurance (PMI), if applicable

End of Page

159 . Review

Seller expenses usually include:

- Stamp tax on the deed
- Broker commission
- Title fees, such as for clearing the title
- Fees for preparing the deed
- Attorney fees

End of Page

160 . Review

Some expenses paid at closing must be **prorated** or divided proportionately between the buyer and the seller. The most common items that fall into this category include:

- Taxes
- Insurance
- Mortgage interest
- Utilities

*Any item that is prorated is shown on the settlement statement as a debit to one party and a credit to the other party **for the same amount**.*

End of Page

161 . Review

Some items are those that were paid for **in advance**; so the buyer will owe the seller part of the payment. *For items paid in advance, the buyer will receive a debit and the seller will receive a credit.*

Other items are those expenses that the seller incurred but have not yet been billed for at the time of closing. These items are **paid in arrears**. On the settlement statement for those items, *the buyer will get a credit and the seller will get a debit.*

End of Page

162 . Review

Closing agents and lenders typically use one of two methods when calculating items that need to be prorated.

The **12-month/30-day method** calculates the amounts due based on a 360-day year and a 30-day month. The steps of this method are as follows.

1. Identify an item and the amount needing to be prorated.
2. Divide by 12 to get the monthly rate.
3. Divide by 30 to get a daily rate.
4. Multiply the monthly rate by the number of months the seller owned the property before closing to get the months-amount due.
5. Multiply the daily rate by the number of days the seller owned the property in the closing month to get the amount due for the closing month.

NOTE: In Pennsylvania, the seller owns the property until the closing date, so the calculation to obtain the prorated amounts will *include the closing date for the seller.*

6. Add the two amounts to get the prorated amount for the seller.
7. Subtract the seller's prorated amount from the starting amount to get the buyer's prorated amount.

End of Page

163 . Review

The **365-day method** calculates the amounts on the basis of a 365-day year.

1. Identify an item and the amount needing to be prorated.
2. Divide by 365 to get the daily rate. (Divide by 366 in a leap year.)
3. Multiply the daily rate by the number of days the seller owned the property before closing to get the seller's share.
4. Subtract the seller's prorated amount from the starting amount to get the buyer's prorated amount.

End of Page

164 . Review

Congratulations!! You've reached the end of the review chapter and the end of the course. Now you're ready to take your course final.

Important:

The course final is a comprehensive exam that is more exhaustive than the quizzes. Our quizzes are one of many review tools we provide for you. Taken alone, the quizzes in fact may not cover all of the material in the course. That is why we also provide additional review resources such as the math guide, textbook, practice exams, and key point summaries (refer to supplemental materials grid at the top of your course outline).

Our final test is a comprehensive exam requiring both the application of the concepts in addition to memorization of terms and laws. Finally, both the questions and exam must conform to the state requirements. The finals, because of the type of questions they are, require a more analytical and interpretive reading. The purpose here is to pass those students who do can demonstrate a thorough knowledge of all the material both presented and assigned. In turn, if you have not applied yourself diligently in this manner, you may very likely fail. So study hard!

Good luck!

End of Page