Real Estate License Exam Prep: The National Exam

First edition | 10 units | 50 lessons + a full practice exam | A video for every lesson

FIRST EDITION

Course guide

This is a full-year, career-pathway course for high-school students (grades 11–12) who want to earn a real estate license soon after graduation. Every state licenses its own real estate agents, and every state's licensing exam has two parts: a **national portion**, written by the testing company and shared by most states, and a **state portion** on that state's own license law. The national portion is the larger part — commonly 80 scored questions — and it covers the same ground everywhere: property and its description, ownership, land use, valuation, financing, contracts, agency, disclosure, fair housing, the practice of real estate and real estate math. This course teaches that national body of knowledge thoroughly, so that a student who finishes it will know the answers to most of the questions on the national portion before ever opening a state pre-licensing course.

The course is built on the two published national outlines used by the testing companies that serve the Pacific Northwest and most of the country — PSI's 2023 national content outline and Pearson VUE's 2025 national outline. The ten units follow those outlines topic for topic, and the full-length final exam is weighted the way the real exam is weighted, with contracts and agency — the two largest sections — receiving the most attention. Unit 10 then orients the student to the state portion in Washington, Oregon, Idaho, Montana and Alaska and shows how to study any state's license law from its official handbook.

Every lesson begins with a true story — a colonial surveyor walking a boundary with a chain, the Supreme Court deciding whether a village in Ohio could zone its land, the savings-and-loan crisis that gave America its appraisal law, an English statute of 1677 that still decides whether a real estate contract can be enforced. A rule whose reason you know is a rule you do not have to memorize. Then come the big idea, the mechanics, worked examples, a hands-on project that builds a real document for the student's pathway file, a picture study, an exam-style practice set and a family game.

The course pairs with the School Launch **Real Estate: Agent & Investor** job pathway, which explains the career and the investing side of the field.

One honest word about what this course is and is not. It does not replace the pre-licensing education your state requires — 90 hours in Washington, 150 in Oregon, 90 in Idaho, 70 in Montana and 40 in Alaska (as of 2026) — and you cannot sit the exam without that certificate. Those hours count only when they come from the specific courses your state requires, taken from a school or provider the state's licensing agency has approved (in a classroom, by live video or online where the state allows), completed in full with each course's final exam passed, and finished within the state's time window. This course, high-school classes and unapproved college classes do not count toward them; Lesson 10.4 gives each Northwest state's exact rules. What this course does is let you walk into that required course already knowing most of the national material, so that the state course becomes review and the exam becomes a confirmation rather than a gamble. Licensing waits for adulthood — 18 in most states, 19 in Alaska — and that is exactly why high school is the time to learn the ground.

> Videos were chosen lesson by lesson from public and educational sources where possible — federal agencies such as the Consumer Financial Protection Bureau, HUD, the EPA and the Bureau of Land Management, Khan Academy, university extension channels and museum and history channels — and every video was checked in preview for accuracy and content. Real estate licensing has few general-audience explainers, so many law and math lessons use videos from teachers who also sell exam-prep materials; their teaching was previewed and stands on its own, and nothing in this course requires buying anything. License rules, fees and dollar figures change and differ by state, so treat any numbers in a video as examples and check the current figures with your state's real estate commission.

Start with Lesson 1.1 →

Who it is for

Written for students in grades 11–12. The only math prerequisite is comfort with percents, decimals, area and simple formulas (Algebra I is plenty); the heavier load is vocabulary and careful reading, which the course builds gradually with constant

review. The School Launch Personal Finance & Investing course and the Real Estate: Agent & Investor pathway are helpful companions but not required. Students work fairly independently; a parent or mentor checks the practice sets, discusses the ethics and fair-housing cases and proctors the timed exams. Licensing is a state decision: every state requires an applicant to be an adult (18 in Washington, Oregon, Idaho and Montana; 19 in Alaska), to complete a state-approved pre-licensing course, to pass the state exam and, in most states, to pass a fingerprint background check, and a new licensee must work under a supervising broker. Most students should plan to take the required pre-licensing course and sit the real exam near or after graduation.

How to use this course

1. **The weekly rhythm.** Each lesson takes three sessions of about 50 minutes. Session 1: the warm-up, the video, the core ideas and the worked examples. Session 2: the project and the exam notebook. Session 3: the practice set, checked against the answers, with every miss corrected in the notebook. Each unit ends with a test day; the midterm and final each get a review day. At five sessions a week the course fills a school year of about 33 weeks.
2. **Story, then the big idea, then the exam.** Read the core ideas in order. The story explains why the rule exists; the big idea defines it precisely; the middle paragraphs work through the distinctions the exam loves; and the last paragraph, "On the exam today," names exactly how the national exam asks about the topic and the traps it sets.
3. **Answer like the exam.** The unit tests, the midterm and the final are four-choice multiple-choice questions in the style of the national exam. Read every word of the stem, eliminate the two weakest choices first, and choose the best answer — the exam often offers two answers that are partly true. Every answer in this course explains why the right choice is right and why the tempting wrong one is wrong.
4. **The exam notebook.** Keep one bound notebook for the whole year: definitions, comparison tables (void vs. voidable, joint tenancy vs. tenancy in common, the four powers of government), trap lists, formulas, and every missed practice question rewritten correctly with the reason. A real estate exam is half a vocabulary exam, and by Unit 10 the notebook and the index-card deck are the best review tool you will own.

5. **The national portion and your state.** This course teaches the national portion — the part of the exam every state shares. Where states differ (deed of trust vs. mortgage practice, community property, agency disclosure forms, license-law details), the lessons say so and teach the common pattern. Lesson 10.4 then orients you to the state portion and shows you how to study it from your own state's official handbook. When a lesson and your state's law disagree, your state's law wins.
6. **Example numbers are examples.** Prices, rates, fees, loan limits and tax figures change every year and differ by place. Every such figure in this course is labeled an example or dated "as of 2026." The arithmetic is permanent; the numbers are not.
7. **Practice sets.** Each lesson has twelve short-answer problems marked easy, medium, hard and challenge. Do them closed-book first, then check, then rewrite every miss in the notebook. Short answers come first because you must be able to explain a rule before you can recognize it among four choices.
8. **The math.** Real estate math is a small share of the exam but a reliable source of points: area and acreage, commissions, loan-to-value, interest and points, taxes, prorations, appraisal and investment returns. Formulas appear in the lessons where they belong and are gathered for review in Unit 10. Use only a basic calculator, as the testing center does.
9. **Picture study.** Each lesson has one public-domain painting, engraving, map or historic photograph — a surveyor at work, a Dutch house and courtyard, a homestead on the prairie, the Willamette Stone — chosen to open the lesson's theme. Look first, then read.
10. **Timed exams, honestly proctored.** Take each unit test in one sitting with a timer. The midterm (60 questions, 90 minutes) and the final (a full-length practice national exam of 100 questions in 150 minutes) should be proctored by a parent: closed book, a basic calculator, no pauses. Score the final the way a testing company would: 70 correct passes in most states; Oregon sets its line at 75%.
11. **No real recommendations.** The course teaches how real estate, lending and licensing work. It never tells a family what to buy, which lender or brokerage to use, or which school to pay; projects use pretend properties, pretend families and pretend numbers.

Scope and sequence

UNIT 1 · WEEKS 1–4

Land and Its Description

What real property is and what counts as part of it — fixtures, trade fixtures and crops; the physical and economic traits that make land unlike any other asset; the three ways land is described in law, from a colonial surveyor's metes and bounds to the rectangular survey that gridded the West from the Willamette Stone; and the rights above, below and beside the surface, including the water law of the western states.

1.1 Real Property and the Things Fixed to It

1.2 Why Land Is Different: The Characteristics of Real Property

1.3 Metes and Bounds: Walking the Line

1.4 Sections and Townships: The Rectangular Survey and the Recorded Plat

1.5 Above, Below and Beside: Air, Mineral and Water Rights

UNIT 2 · WEEKS 4–7

Ownership, Estates and Encumbrances

The bundle of rights and the estates that hold it — fee simple, defeasible fees and life estates; the leasehold estates; the ways people own together, including joint tenancy, tenancy by the entirety and the community property of Washington and Idaho; condominiums, cooperatives, timeshares, trusts and business owners; and the liens, easements and encroachments that burden a title.

2.1 The Bundle of Rights and the Freehold Estates

2.2 Leasehold Estates: What a Tenant Owns

2.3 Owning Together: Severalty, Tenancy in Common and Joint Tenancy

2.4 Condominiums, Cooperatives, Timeshares and Trusts

2.5 Liens, Easements and Encroachments

UNIT 3 · WEEKS 7–10

Land Use, Taxes and the Environment

The four powers government holds over all land — police power, eminent domain, taxation and escheat; zoning from *Euclid v. Ambler* to the variance and the nonconforming use; private controls through deed restrictions, covenants and owners' associations; property taxes, mill rates and special assessments; and the environmental hazards and federal laws every licensee must recognize, from lead paint and radon to Superfund and the flood zone.

3.1 The Four Powers of Government

3.2 Zoning and Planning: Euclid v. Ambler

3.3 Private Controls: Deed Restrictions, CC&Rs and Owners' Associations

3.4 Property Taxes and Special Assessments

3.5 Environmental Hazards and the Law

UNIT 4 · WEEKS 10–13

Valuation

What value is and what moves it — market value, price and cost, and the principles of substitution, highest and best use, conformity and contribution; the appraiser's process and the federal oversight born of the savings-and-loan crisis; and the three approaches to value — sales comparison with its adjustments, cost with its three kinds of depreciation, and income with cap rates and gross rent multipliers — along with the CMA and the broker price opinion.

4.1 What Makes Value

4.2 The Appraiser and the Appraisal

4.3 The Sales Comparison Approach

4.4 The Cost Approach and Depreciation

4.5 The Income Approach

UNIT 5 · WEEKS 13–17

Financing: Notes, Loans and Lenders

How a home is bought with borrowed money — the promissory note, the mortgage and the deed of trust and the clauses inside them; the arithmetic of interest, points, loan-to-value and PITI; conventional, FHA, VA and USDA loans; adjustable, balloon, reverse and seller-financed loans; and where the money comes from and what happens when it is not repaid — the secondary market, foreclosure, redemption and the short sale.

5.1 Notes, Mortgages and Deeds of Trust

5.2 Loan Arithmetic: Interest, Points, LTV and PITI

5.3 Conventional, FHA, VA and USDA Loans

5.4 ARMs, Balloons, Reverse Mortgages and Seller Financing

5.5 The Secondary Market and Foreclosure

UNIT 6 · WEEKS 17–20

Lending Law, Title and Closing

The federal laws that govern the loan — Truth in Lending, the Equal Credit Opportunity Act, RESPA and the TRID disclosures; then how ownership actually changes hands — the deed and its types, voluntary and involuntary alienation, probate and adverse possession; recording, the chain of title and title insurance; and the closing table itself, with prorations, debits and credits and the seller's net.

6.1 Truth in Lending and the Fair Lender

6.2 RESPA, TRID and the Closing Disclosures

6.3 Deeds and the Transfer of Title

6.4 Recording, Title Search and Title Insurance

6.5 The Closing: Prorations, Debits and Credits

UNIT 7 · WEEKS 20–23

Contracts

The largest single section of the national exam — what makes a contract valid, void, voidable or unenforceable, and why real estate contracts must be in writing; performance, breach and remedies; the purchase agreement from offer and counteroffer to earnest money, contingencies and multiple offers; options, rights of first refusal and installment contracts; and the lease and the law of landlord and tenant.

7.1 What Makes a Contract Valid

7.2 Performance, Breach and Remedies

7.3 The Purchase Agreement

7.4 Options, Rights of First Refusal and Installment Contracts

7.5 Leases and the Law of Landlord and Tenant

UNIT 8 · WEEKS 24–27

Agency and Disclosure

Whom a licensee works for and what is owed — principals, agents and customers and how agency is created and ended; the fiduciary duties of obedience, loyalty, disclosure, confidentiality, accounting and reasonable care; listing agreements; buyer agency, dual agency and other brokerage relationships; and the seller's and licensee's duty to disclose material facts and defects.

8.1 What Agency Is: Principals, Agents and Customers

8.2 The Fiduciary Duties

8.3 Listing Agreements

8.4 Buyer Agency, Dual Agency and Other Relationships

8.5 Property Disclosures and Material Facts

UNIT 9 · WEEKS 27–30

The Practice of Real Estate

The law of the working day — the federal fair-housing laws and their history; accessibility under the Americans with Disabilities Act and reasonable accommodations; antitrust and the handling of other people's money in trust; running a lawful brokerage, from independent-contractor status and supervision to do-not-call, advertising and the unauthorized practice of law; and property management.

9.1 Fair Housing: The Law and Its History

9.2 Accessibility, Accommodations and Fair Treatment

9.3 Antitrust and Other People's Money

9.4 Running a Lawful Brokerage

9.5 Property Management

UNIT 10 · WEEKS 30–33

The Math, the State Exam and the Road to the License

The calculations the exam asks — percentages and the T-bar, area and acreage, commissions, loan costs, taxes, prorations and investment returns with their tax treatment; an orientation to the state portion of the exam in Washington, Oregon, Idaho, Montana and Alaska and how to study any state's license law; and exam day, the licensing steps and the full-length practice national exam.

10.1 The Math Toolkit: Percentages, Area and Acreage

10.2 Money Math: Commissions, Loans, Taxes and Prorations

10.3 Investment Math and the Taxman

10.4 The State Portion: License Law in the Northwest and Beyond

10.5 Exam Day and the Road to the License

Weekly pacing calendar

WEEK	PLAN
1	• Day 1: Lesson 1.1 Real Property and the Things Fixed to It: video, teaching and worked examples • Day 2: Lesson 1.1: project and notebook • Day 3: Lesson 1.1: practice set and corrections • Day 4: Lesson 1.2 Why Land Is Different: The Characteristics of Real Property: video, teaching and worked examples • Day 5: Lesson 1.2: project and notebook *Five sessions a week of about 50 minutes. Families on a four-day week can combine the practice day of one lesson with the teaching day of the next.*
2	• Day 1: Lesson 1.2: practice set and corrections • Day 2: Lesson 1.3 Metes and Bounds: Walking the Line: video, teaching and worked examples

WEEK	PLAN
	• Day 3: Lesson 1.3: project and notebook • Day 4: Lesson 1.3: practice set and corrections • Day 5: Lesson 1.4 Sections and Townships: The Rectangular Survey and the Recorded Plat: video, teaching and worked examples
3	• Day 1: Lesson 1.4: project and notebook • Day 2: Lesson 1.4: practice set and corrections • Day 3: Lesson 1.5 Above, Below and Beside: Air, Mineral and Water Rights: video, teaching and worked examples • Day 4: Lesson 1.5: project and notebook • Day 5: Lesson 1.5: practice set and corrections
4	• Day 1: Unit 1 test • Day 2: Lesson 2.1 The Bundle of Rights and the Freehold Estates: video, teaching and worked examples • Day 3: Lesson 2.1: project and notebook • Day 4: Lesson 2.1: practice set and corrections • Day 5: Lesson 2.2 Leasehold Estates: What a Tenant Owns: video, teaching and worked examples
5	• Day 1: Lesson 2.2: project and notebook • Day 2: Lesson 2.2: practice set and corrections • Day 3: Lesson 2.3 Owning Together: Severalty, Tenancy in Common and Joint Tenancy: video, teaching and worked examples • Day 4: Lesson 2.3: project and notebook • Day 5: Lesson 2.3: practice set and corrections
6	• Day 1: Lesson 2.4 Condominiums, Cooperatives, Timeshares and Trusts: video, teaching and worked examples • Day 2: Lesson 2.4: project and notebook • Day 3: Lesson 2.4: practice set and corrections • Day 4: Lesson 2.5 Liens, Easements and Encroachments: video, teaching and worked examples • Day 5: Lesson 2.5: project and notebook
7	• Day 1: Lesson 2.5: practice set and corrections • Day 2: Unit 2 test

WEEK	PLAN
	• Day 3: Lesson 3.1 The Four Powers of Government: video, teaching and worked examples • Day 4: Lesson 3.1: project and notebook • Day 5: Lesson 3.1: practice set and corrections
8	• Day 1: Lesson 3.2 Zoning and Planning: Euclid v. Ambler: video, teaching and worked examples • Day 2: Lesson 3.2: project and notebook • Day 3: Lesson 3.2: practice set and corrections • Day 4: Lesson 3.3 Private Controls: Deed Restrictions, CC&Rs and Owners' Associations: video, teaching and worked examples • Day 5: Lesson 3.3: project and notebook
9	• Day 1: Lesson 3.3: practice set and corrections • Day 2: Lesson 3.4 Property Taxes and Special Assessments: video, teaching and worked examples • Day 3: Lesson 3.4: project and notebook • Day 4: Lesson 3.4: practice set and corrections • Day 5: Lesson 3.5 Environmental Hazards and the Law: video, teaching and worked examples
10	• Day 1: Lesson 3.5: project and notebook • Day 2: Lesson 3.5: practice set and corrections • Day 3: Unit 3 test • Day 4: Lesson 4.1 What Makes Value: video, teaching and worked examples • Day 5: Lesson 4.1: project and notebook
11	• Day 1: Lesson 4.1: practice set and corrections • Day 2: Lesson 4.2 The Appraiser and the Appraisal: video, teaching and worked examples • Day 3: Lesson 4.2: project and notebook • Day 4: Lesson 4.2: practice set and corrections • Day 5: Lesson 4.3 The Sales Comparison Approach: video, teaching and worked examples
12	• Day 1: Lesson 4.3: project and notebook • Day 2: Lesson 4.3: practice set and corrections

WEEK	PLAN
	• Day 3: Lesson 4.4 The Cost Approach and Depreciation: video, teaching and worked examples • Day 4: Lesson 4.4: project and notebook • Day 5: Lesson 4.4: practice set and corrections
13	• Day 1: Lesson 4.5 The Income Approach: video, teaching and worked examples • Day 2: Lesson 4.5: project and notebook • Day 3: Lesson 4.5: practice set and corrections • Day 4: Unit 4 test • Day 5: Lesson 5.1 Notes, Mortgages and Deeds of Trust: video, teaching and worked examples
14	• Day 1: Lesson 5.1: project and notebook • Day 2: Lesson 5.1: practice set and corrections • Day 3: Lesson 5.2 Loan Arithmetic: Interest, Points, LTV and PITI: video, teaching and worked examples • Day 4: Lesson 5.2: project and notebook • Day 5: Lesson 5.2: practice set and corrections
15	• Day 1: Lesson 5.3 Conventional, FHA, VA and USDA Loans: video, teaching and worked examples • Day 2: Lesson 5.3: project and notebook • Day 3: Lesson 5.3: practice set and corrections • Day 4: Lesson 5.4 ARMs, Balloons, Reverse Mortgages and Seller Financing: video, teaching and worked examples • Day 5: Lesson 5.4: project and notebook
16	• Day 1: Lesson 5.4: practice set and corrections • Day 2: Lesson 5.5 The Secondary Market and Foreclosure: video, teaching and worked examples • Day 3: Lesson 5.5: project and notebook • Day 4: Lesson 5.5: practice set and corrections • Day 5: Unit 5 test
17	• Day 1: Review day for the midterm • Day 2: Midterm exam (60 questions, 90 minutes, one sitting) • Day 3: Lesson 6.1 Truth in Lending and the Fair Lender: video, teaching and worked examples

WEEK	PLAN
	• Day 4: Lesson 6.1: project and notebook • Day 5: Lesson 6.1: practice set and corrections
18	• Day 1: Lesson 6.2 RESPA, TRID and the Closing Disclosures: video, teaching and worked examples • Day 2: Lesson 6.2: project and notebook • Day 3: Lesson 6.2: practice set and corrections • Day 4: Lesson 6.3 Deeds and the Transfer of Title: video, teaching and worked examples • Day 5: Lesson 6.3: project and notebook
19	• Day 1: Lesson 6.3: practice set and corrections • Day 2: Lesson 6.4 Recording, Title Search and Title Insurance: video, teaching and worked examples • Day 3: Lesson 6.4: project and notebook • Day 4: Lesson 6.4: practice set and corrections • Day 5: Lesson 6.5 The Closing: Prorations, Debits and Credits: video, teaching and worked examples
20	• Day 1: Lesson 6.5: project and notebook • Day 2: Lesson 6.5: practice set and corrections • Day 3: Unit 6 test • Day 4: Lesson 7.1 What Makes a Contract Valid: video, teaching and worked examples • Day 5: Lesson 7.1: project and notebook
21	• Day 1: Lesson 7.1: practice set and corrections • Day 2: Lesson 7.2 Performance, Breach and Remedies: video, teaching and worked examples • Day 3: Lesson 7.2: project and notebook • Day 4: Lesson 7.2: practice set and corrections • Day 5: Lesson 7.3 The Purchase Agreement: video, teaching and worked examples
22	• Day 1: Lesson 7.3: project and notebook • Day 2: Lesson 7.3: practice set and corrections • Day 3: Lesson 7.4 Options, Rights of First Refusal and Installment Contracts: video, teaching and worked examples • Day 4: Lesson 7.4: project and notebook • Day 5: Lesson 7.4: practice set and corrections

WEEK	PLAN
23	• Day 1: Lesson 7.5 Leases and the Law of Landlord and Tenant: video, teaching and worked examples • Day 2: Lesson 7.5: project and notebook • Day 3: Lesson 7.5: practice set and corrections • Day 4: Unit 7 test • Day 5: Lesson 8.1 What Agency Is: Principals, Agents and Customers: video, teaching and worked examples
24	• Day 1: Lesson 8.1: project and notebook • Day 2: Lesson 8.1: practice set and corrections • Day 3: Lesson 8.2 The Fiduciary Duties: video, teaching and worked examples • Day 4: Lesson 8.2: project and notebook • Day 5: Lesson 8.2: practice set and corrections
25	• Day 1: Lesson 8.3 Listing Agreements: video, teaching and worked examples • Day 2: Lesson 8.3: project and notebook • Day 3: Lesson 8.3: practice set and corrections • Day 4: Lesson 8.4 Buyer Agency, Dual Agency and Other Relationships: video, teaching and worked examples • Day 5: Lesson 8.4: project and notebook
26	• Day 1: Lesson 8.4: practice set and corrections • Day 2: Lesson 8.5 Property Disclosures and Material Facts: video, teaching and worked examples • Day 3: Lesson 8.5: project and notebook • Day 4: Lesson 8.5: practice set and corrections • Day 5: Unit 8 test
27	• Day 1: Lesson 9.1 Fair Housing: The Law and Its History: video, teaching and worked examples • Day 2: Lesson 9.1: project and notebook • Day 3: Lesson 9.1: practice set and corrections • Day 4: Lesson 9.2 Accessibility, Accommodations and Fair Treatment: video, teaching and worked examples • Day 5: Lesson 9.2: project and notebook
28	• Day 1: Lesson 9.2: practice set and corrections

WEEK	PLAN
	• Day 2: Lesson 9.3 Antitrust and Other People's Money: video, teaching and worked examples • Day 3: Lesson 9.3: project and notebook • Day 4: Lesson 9.3: practice set and corrections • Day 5: Lesson 9.4 Running a Lawful Brokerage: video, teaching and worked examples
29	• Day 1: Lesson 9.4: project and notebook • Day 2: Lesson 9.4: practice set and corrections • Day 3: Lesson 9.5 Property Management: video, teaching and worked examples • Day 4: Lesson 9.5: project and notebook • Day 5: Lesson 9.5: practice set and corrections
30	• Day 1: Unit 9 test • Day 2: Lesson 10.1 The Math Toolkit: Percentages, Area and Acreage: video, teaching and worked examples • Day 3: Lesson 10.1: project and notebook • Day 4: Lesson 10.1: practice set and corrections • Day 5: Lesson 10.2 Money Math: Commissions, Loans, Taxes and Prorations: video, teaching and worked examples
31	• Day 1: Lesson 10.2: project and notebook • Day 2: Lesson 10.2: practice set and corrections • Day 3: Lesson 10.3 Investment Math and the Taxman: video, teaching and worked examples • Day 4: Lesson 10.3: project and notebook • Day 5: Lesson 10.3: practice set and corrections
32	• Day 1: Lesson 10.4 The State Portion: License Law in the Northwest and Beyond: video, teaching and worked examples • Day 2: Lesson 10.4: project and notebook • Day 3: Lesson 10.4: practice set and corrections • Day 4: Lesson 10.5 Exam Day and the Road to the License: video, teaching and worked examples • Day 5: Lesson 10.5: project and notebook
33	• Day 1: Lesson 10.5: practice set and corrections • Day 2: Unit 10 test • Day 3: Review day for the final

WEEK	PLAN
	• Day 4: Final exam: a full-length practice national exam (100 questions, two and a half hours, one sitting) • Day 5: Score the final as a testing company would (70 of 100 passes in most states; 75 in Oregon), review every miss, and plan the real licensing steps with your parents

Materials

A basic calculator

A simple four-function calculator with a percent key is enough; testing centers provide or allow only a basic calculator, so practice with nothing fancier.

Exam notebook (a bound notebook), pencil and ruler

For definitions, comparison tables, trap lists, formulas, sketches of surveys and estates, and every corrected practice question — the single most valuable study tool in the course.

Index cards

For the vocabulary. Build the deck unit by unit; by Unit 10 it will hold about 500 cards.

Free spreadsheet software (Google Sheets or LibreOffice Calc)

Used in several projects: an amortization table, a closing statement with prorations, a sales-comparison grid and an investment analysis.

Your county's assessor and recorder websites

Free and public. Several projects use real public records — parcel maps, legal descriptions, assessed values and recorded deeds — from your own county.

Your state real estate commission's website and the testing company's candidate handbook

Free and official. Used in Lessons 10.4 and 10.5 and whenever a lesson says "check your state."

A kitchen timer or stopwatch

Exam training is time training: about a minute and a half per question. Used on every unit test and for the proctored midterm and final.

Optional: one of the books or resources listed in a unit

Never required. See the list in each unit.

Grading

Grades come from the practice sets, the projects, the exam notebook, the ten unit tests, the midterm and the full-length practice final. A multiple-choice answer earns credit only when the student can defend it; on review days, pick five questions at random and ask "why is this the answer, and why are the other three wrong?" A calculation earns full credit when the formula, the substitution and the answer with its units are all shown.

PART	%
Practice sets (completed and corrected)	**15**
Projects (real numbers, organization, explanation)	**20**
Exam notebook (definitions, tables, trap lists, corrected misses)	**10**
Unit tests	**30**
Midterm exam (60 questions, timed)	**10**
Final exam (full-length 100-question practice national exam, timed)	**15**

Scale: A 90–100, B 80–89, C 70–79, D 60–69, F below 60.

- Practice sets are graded for completion and correction, not first-try accuracy: a question missed, understood and rewritten in the notebook earns full credit.
- The final is also reported the way a testing company would score it: 70 of 100 passes in most states (Oregon requires 75%). A student who passes the course final under honest exam conditions knows most of the national portion and is ready for the state-required pre-licensing course.
- A project earns full marks when its numbers are complete and labeled, its totals are correct, and it ends with a paragraph on what the student learned.

- For a high-school transcript this course is one full credit of business (career and technical education). Keep the exam notebook, the projects and the scored practice final as the course portfolio.

A NOTE TO PARENTS

You do not need a real estate background to run this course well. Your jobs are to keep the rhythm (three sessions per lesson), check the practice sets against the answers, ask the student to defend a few answers aloud each week, discuss the ethics and fair-housing cases at the table, and proctor the three timed exams honestly — closed book, full time, no pauses. The course explains itself; the student does the work.

Be clear-eyed about what this course does. It teaches the national portion of the licensing exam thoroughly — the larger part of every state's test — but it is not a state-approved pre-licensing course, and no state accepts it in place of one. Your student will still need to complete the state's required pre-licensing hours (as of 2026: 90 in Washington and Idaho, 150 in Oregon, 70 in Montana, 40 in Alaska). Only the state's specific required courses count, taken from a school the state has approved, finished in full with each course exam passed and within the state's time window (for example, Idaho's must fall within three years before applying and Montana's within 24 months); this course does not count toward them. Those hours are usually taken near or after the 18th birthday (19 in Alaska), so that they are still current when the student applies. After that the student must pass the exam and a background check and join a supervising brokerage. What this course changes is the student who walks into that required course: one who already knows the vocabulary, the law and the math, and who can treat the state course as review.

Real estate law touches some subjects families care about deeply. The fair-housing lessons teach the federal law as settled law and history — what it requires, what it forbids, how it is enforced — because every licensee is bound by it and every exam tests it; the lessons do not argue current policy. The course is also plain about money: commissions are negotiable and uncertain, most new agents earn little their first year, and borrowing is a serious thing. That honesty is part of the training.

Use the projects. Several send the student to your county's public records — a real parcel map, a real recorded deed, a real tax statement — and a few work best if you

share, with whatever privacy you like, your own family's closing statement or mortgage paperwork. Nothing teaches settlement arithmetic like a real Closing Disclosure read line by line at the kitchen table.

Finally, enjoy it. The law of land is old and humane: it is the long human effort to keep promises about the ground under our feet. A student who finishes this course will read a deed, a contract and a loan estimate as an informed adult — useful whether or not they ever hold a license. *Fabricando fit faber.*

UNIT 1

Land and Its Description

Every real estate transaction begins with two questions: *what* is being sold, and *where* exactly is it? This unit answers both. You will start inside an Ohio woolen mill in 1853, where a court had to decide whether the machines belonged to the land, and learn the difference between **land**, **real estate** and **real property**, the five tests for a **fixture**, and the rules for **trade fixtures** and **emblements**. You will see why land behaves unlike any other thing people buy — immobile, indestructible, unique — through the night Secretary Seward bought Alaska for two cents an acre.

Then you will learn to describe land the way the law does. You will walk a boundary with the young surveyor George Washington and write a **metes-and-bounds** description that closes; stand with John B. Preston at the cedar stake that became the Willamette Stone and count **townships** and **sections** across the **rectangular survey**; and read a **lot-and-block** description from a recorded plat. You will finish below the ground and above it, with mineral and air rights, and beside the water, with the **riparian**, **littoral** and **prior appropriation** doctrines that decide who may use a river. This unit carries some of the most dependable points on the national exam — vocabulary and acreage arithmetic — so keep your calculator and your index cards close.

PREREQUISITES

- Can multiply and divide by fractions such as ¼ and ½ and convert between feet and miles
- Can compute the area of a rectangle and divide large numbers on a basic calculator
- Has read the course introduction and set up a bound exam notebook and an index-card deck
- Can read a simple map with north, south, east and west

MASTERY CHECKLIST

- ☐ I can distinguish land, real estate and real property, and tell real from personal property.
- ☐ I can apply the five MARIA fixture tests and state that a written agreement overrides the others.
- ☐ I can explain trade fixtures, accession and emblements, and how annexation and severance change property's character.
- ☐ I can name and classify the three physical and four economic characteristics of land and the five rights in the bundle.
- ☐ I can read and write a metes-and-bounds description that returns to its point of beginning, and convert chains, rods and feet.
- ☐ I can number a township's 36 sections and compute the acreage of any aliquot part of a section.
- ☐ I can explain lot-and-block descriptions, correction lines and government lots, and name the meridians of the Northwest states.
- ☐ I can distinguish riparian, littoral and prior-appropriation rights and define accretion, alluvion, reliction, erosion and avulsion.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Bureau of Land Management: Cadastral Survey**: Free, official. The federal agency that runs the Public Land Survey System explains how the rectangular survey works and why it still matters. Read it with Lesson 1.4 before you build your township grid. Ages 14 and up.
- **BLM General Land Office Records**: Free, official. A searchable archive of original survey plats, field notes and land patents for the public-land states, including the Northwest. Use it in Lesson 1.4's project to find the original survey of your own township. Ages 14 and up.
- **NOAA National Geodetic Survey**: Free, official. The agency that maintains the nation's benchmarks and datums; its data explorer shows survey marks near your home. Use it for the Lesson 1.3 extension. Ages 15 and up.
- **Oregon Water Resources Department: Water Rights**: Free, official. Oregon's water agency explains prior appropriation, permits and priority dates under the state's water code. Read it with Lesson 1.5 for the water-rights brief. Ages 15 and up.
- **Washington Department of Ecology: Water Rights**: Free, official. Washington's agency for water rights explains how rights are obtained, which uses are exempt and how seniority works. A second state's view for Lesson 1.5 — compare it with your own state's agency. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

1.1 Real Property and the Things Fixed to It — 3 sessions of 50 minutes

1.2 Why Land Is Different: The Characteristics of Real Property
3 sessions of 50 minutes

1.3 Metes and Bounds: Walking the Line — 3 sessions of 50 minutes

1.4 Sections and Townships: The Rectangular Survey and the Recorded Plat
3 sessions of 50 minutes

1.5 Above, Below and Beside: Air, Mineral and Water Rights — 3 sessions of 50 minutes

Unit 1 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions in the style of the national exam, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. A score of 70% (14 of 20) matches the common passing line, but aim higher. Figures marked “in this example” are examples. Choose the one BEST answer.

1. **5 pts**

   Land plus the permanent improvements people have attached to it is BEST described as:

   A. Personal property

   B. Real estate

   C. Land

   D. A chattel real

2. **5 pts**

   When the parties disagree about whether an item is a fixture, which of the following controls over all the other tests?

   A. The method of attachment

   B. The adaptation of the item to the property

   C. The relationship of the parties

   D. A written agreement between the parties

3. **5 pts**

   A florist leasing a shop installs refrigerated display cases bolted to the wall. The lease expires, and the florist leaves the cases behind. The cases now belong to the landlord by:

   A. Accession

   B. Severance

   C. Emblements

   D. Adverse possession

4. 5 pts

A tenant farmer plants wheat in the spring. In midsummer the owner, who rented the field to him at will, ends the tenancy. Which statement is MOST accurate?

A. The wheat is real property and belongs to the owner

B. The farmer may return to harvest the wheat as emblements

C. The wheat is fructus naturales

D. The farmer must be paid the market value of the land

5. 5 pts

An owner cuts down a dead walnut tree and stacks the logs to sell. The logs are now:

A. Real property by annexation

B. A fixture

C. Personal property by severance

D. Fructus naturales still attached to the land

6. 5 pts

Which of the following is NOT a physical characteristic of land?

A. Immobility

B. Indestructibility

C. Uniqueness

D. Situs

7. 5 pts

A court orders a seller who refused to close to convey the property to the buyer as agreed. The characteristic of land that BEST justifies this remedy is:

A. Nonhomogeneity

B. Scarcity

C. Permanence of investment

D. Immobility

8. 5 pts

Which of the following is an improvement TO the land rather than an improvement ON the land?

A. A detached garage

B. A barn

C. A sewer line serving the subdivision

D. A backyard fence

9. 5 pts

A spring flood suddenly tears away three acres of a riverside farm and deposits them downstream. This loss of land is called:

A. Avulsion

B. Accretion

C. Reliction

D. Alluvion

10. 5 pts

A valid metes-and-bounds description must:

A. Begin at the corner of a section

B. End at the last monument named

C. Refer to a principal meridian

D. Return to the point of beginning

11. 5 pts

Which of the following is a properly written bearing in a metes-and-bounds description?

A. E 45° N

B. N 95° E

C. S 30° W

D. W 10° S

12. 5 pts

A deed calls for a boundary “thence 300 feet to an iron pin,” but the pin is found 296 feet away. In most cases the boundary runs:

A. To the iron pin, because monuments generally control over distances

B. Exactly 300 feet, because distances control over monuments

C. To a point halfway between

D. Nowhere, because the description is void

13. 5 pts

How many feet are in 30 rods?

A. 330 feet

B. 450 feet

C. 495 feet

D. 1,980 feet

14. 5 pts

Rectangular survey descriptions in both Washington and Oregon are measured from which principal meridian?

A. The Boise Meridian

B. The Willamette Meridian

C. The Principal Meridian Montana

D. The Seward Meridian

15. 5 pts

In a standard township, Section 36 is located in which corner?

A. Northeast

B. Northwest

C. Southwest

D. Southeast

16. 5 pts

How many acres are in the N½ of the SE¼ of the NW¼ of a section?

A. 10 acres

B. 20 acres

C. 40 acres

D. 80 acres

17. 5 pts

A farm is described as "the W½ of the NE¼ and the NE¼ of the SE¼ of Section 8." How many acres does it contain?

A. 60 acres

B. 100 acres

C. 120 acres

D. 160 acres

18. 5 pts

"Lot 14, Block 2, Cedar Hills Addition, as recorded in Book 9 of Plats, page 31" is an example of which kind of legal description?

A. Lot and block (recorded plat)

B. Metes and bounds

C. Rectangular survey

D. Assessor's parcel number

19. 5 pts

The owner of a cottage on the shore of a large lake holds which kind of water rights?

A. Riparian

B. Littoral

C. Avulsive

D. Subjacent

20. 5 pts

Under the doctrine of prior appropriation used in the western states:

A. Only owners of land bordering the water may use it

B. All users share water equally in a drought

C. A water right, once granted, can never be lost

D. The first to put the water to beneficial use under state law has the senior right

ANSWER KEY

1. B. Real estate is land plus permanent man-made improvements. Real property adds the bundle of legal rights; land alone includes only natural attachments.
2. D. A written agreement overrides every other test. Absent an agreement, intention is usually considered the most important legal test; method of attachment (A) is only one piece of evidence of intention.
3. A. The cases were trade fixtures, the tenant's personal property, removable before the lease expired; left behind, they become the landlord's by accession. Severance (B) is the opposite process — detaching an item.
4. B. Annual crops produced by labor are emblements (fructus industriales), personal property, and a tenant whose tenancy ends through no fault of his own may return to harvest them. Fructus naturales (C) are trees and perennial plants.
5. C. Cutting the tree severed it from the land, converting real property into personal property. Annexation (A) is the reverse — attaching personal property to land.
6. D. Situs (area preference) is an economic characteristic. The three physical characteristics are immobility, indestructibility and uniqueness.
7. A. Because every parcel is unique (nonhomogeneous), money damages cannot buy an identical substitute, so courts may order specific performance. Scarcity (B) is economic and does not explain why this particular parcel cannot be replaced.
8. C. Infrastructure such as sewers, streets and utilities is an improvement to the land, making it usable for building. Garages, barns and fences are improvements on the land.
9. A. Avulsion is the sudden loss of land by a natural force, and the boundary generally does not move. Accretion (B) and reliction (C) add land gradually; alluvion (D) is the deposited soil itself.
10. D. A metes-and-bounds description must close by returning to the point of beginning. Section corners and meridians (A, C) belong to the rectangular survey, which a metes-and-bounds description may or may not use.
11. C. Bearings begin with north or south, give an angle from 0 to 90 degrees, and end with east or west. A and D start with east or west; B exceeds 90 degrees.
12. A. Monuments generally control over courses and distances, because the parties could see the monument. A small discrepancy does not void a description.

13. C. A rod is 16½ feet: $30 \times 16.5 = 495$ feet. D uses 66 feet, the length of a chain.
14. B. The Willamette Meridian, measured from the Willamette Stone near Portland, governs both states. Idaho uses the Boise Meridian, Montana the Principal Meridian Montana, and the Seward Meridian is one of Alaska's five.
15. D. Section 1 is in the northeast corner, and the numbering snakes back and forth row by row so that Section 36 lands in the southeast corner.
16. B. $640 \times \frac{1}{2} \times \frac{1}{4} \times \frac{1}{4} = 20$ acres. C forgets the half.
17. C. The word "and" creates two parcels: $640 \times \frac{1}{2} \times \frac{1}{4} = 80$ acres plus $640 \times \frac{1}{4} \times \frac{1}{4} = 40$ acres, for 120 acres.
18. A. A lot-and-block description refers to a subdivision plat recorded in the county records. An assessor's parcel number (D) is a tax identifier, not a legal description.
19. B. Littoral rights belong to owners bordering large still or tidal bodies of water — lakes, seas and oceans. Riparian rights (A) concern flowing water such as rivers and streams.
20. D. Prior appropriation is "first in time, first in right," based on beneficial use and a right obtained through the state; unused rights may be lost. A describes the riparian idea, which prior appropriation rejects.

PORTFOLIO PIECE: MY PATHWAY FILE — THE LAND PAGES

Assemble the first section of your Pathway File: the Stays-or-Goes fixture inventory with its five disputed items and contract lines (1.1); the Seven Characteristics field guide to your town, with its two assessor land values labeled as examples (1.2); the Walk the Line metes-and-bounds description of a real lot, plotted to scale with its closure error explained (1.3); My Place on the Grid, with your numbered township, shaded section and full rectangular and lot-and-block descriptions (1.4); and the Three-Dimensional Parcel poster with its dated state water-rights brief (1.5).

Close the section with a one-page cover memo to a pretend first buyer of a rural acreage: in your own words, explain the three ways land is described, the questions you would ask about fixtures, minerals and water before writing an offer, and why a survey is worth its cost. End by quoting Deuteronomy 19:14 and explaining in one sentence what a landmark has to do with the work of a real estate licensee. Date every page.

LOOK FOR	WHAT IT MEANS
Fixture inventory	At least twenty items are classified with the attachment noted for each, the tests are applied in the correct order (agreement first), and the five disputed items each carry a clear inclusion or exclusion line.
Characteristics field guide	All seven characteristics have a genuine local example correctly labeled physical or economic, and the assessor comparison is explained with one named characteristic.
Metes-and-bounds description	The description begins at an identifiable point of beginning, uses properly written bearings, returns to the point of beginning, and is plotted to scale with area, rod and chain conversions correct.
Grid and plat descriptions	The township is numbered correctly from memory, aliquot acreages are correct, and the parcel's meridian, township, range, section and (where applicable) lot-and-block description are written in proper form.
Three-dimensional parcel and water brief	Surface, air, mineral, support and water rights are correctly labeled; the four shoreline changes are drawn with the right ownership result; and the water brief is dated and names its state agency.

LOOK FOR	WHAT IT MEANS
Cover memo	Written in the student's own voice, it explains the three description methods accurately, raises fixtures, minerals and water as pre-offer questions, and connects the landmark verse to honest boundary work without canned language.

1.1 Real Property and the Things Fixed to It

OBJECTIVES

- Distinguish land, real estate and real property, and define personal property (chattels) in exam language.
- Apply the five fixture tests — method of attachment, adaptation, relationship of the parties, intention and agreement (MARIA) — to decide whether an item stays with the property.
- Explain trade fixtures, including who owns them, when they must be removed and what accession means.
- Classify crops and plants as emblements (fructus industriales) or fructus naturales, and state the tenant farmer's right to harvest.
- Explain how attachment and severance convert property from personal to real and back, and match the bill of sale and the deed to the property each one transfers.

> **Warm-up.** Walk through one room of your home with a pencil and paper for five minutes. List ten things you see — a ceiling light, a sofa, a window blind, a wall mirror, a rug. Beside each, write "stays" or "goes" for the day your family sells the house. Circle the two you were least sure of; by the end of this lesson you will have a five-part test for them.

WATCH

Fixture or Personal Property? The 5 MARIA Tests Explained

Applecation Lab · 3:30

https://www.youtube.com/watch?v=zGGpKCqQcPk

> **WHEN TO WATCH**
> Watch after the core ideas; as each of the five tests appears, pause and write it in your notebook with one example of your own from the warm-up list.

BACKUP VIDEO

Real Estate Exam Prep: Trade Fixtures and Emblements

Kaplan Real Estate Education · 3:44

https://www.youtube.com/watch?v=1pDkpRrbPMg

Watch before the practice set if trade fixtures and emblements still blur together; write down the one rule he gives for each.

KEY TERMS

land

The earth's surface, extending downward to the center of the earth and upward into the airspace, including things permanently attached by nature such as trees and water.

real estate

Land plus all permanent improvements attached to it by people, such as buildings, fences and driveways.

real property

Real estate plus the bundle of legal rights that come with owning it; the term the law uses for the interests that pass by deed.

personal property

Everything that is not real property — movable items also called chattels or personalty — transferred by a bill of sale.

fixture

An item that was once personal property but has been so attached to or adapted for the real estate that the law treats it as part of the real property.

trade fixture

An item a commercial tenant installs for use in the tenant's business; it remains the tenant's personal property and may be removed before the lease ends.

accession

The acquisition of title to additions or improvements to real property; trade fixtures left behind after the lease ends become the landlord's by accession.

emblements

Annual crops produced by human labor (fructus industriales), treated as personal property; a tenant farmer may return to harvest emblements planted before a tenancy ended through no fault of the tenant.

fructus naturales

"Fruits of nature" — trees, perennial shrubs and grasses that grow without annual cultivation; they are part of the real property until severed.

severance

Detaching an item from the real estate — cutting timber, harvesting a crop, unbolting a fixture — which converts it from real to personal property.

annexation

Attaching personal property to land so that it becomes real property; also called attachment.

bill of sale

The written document that transfers ownership of personal property, as a deed transfers real property.

CORE IDEAS

The story. In May 1848, James Teaff of Ohio signed as surety on four promissory notes for a man named Samuel Hewitt. To protect Teaff, Hewitt gave him a mortgage on a lot that held Hewitt's woolen factory. Hewitt did not pay his debts, and soon other creditors who had won court judgments against him arrived with the sheriff to seize and sell everything inside the mill — the steam engine and boilers, the carding machines, the spinning machines and the power looms. Teaff went to court in 1849. His argument was simple: the machinery was part of the mill, the mill was part of the land, and the land was mortgaged to him. The creditors answered that machines are goods, not land, and goods may be seized and sold like any wagon or barrel. A

carding machine can be moved; a building cannot — but a woolen mill without its machines is an empty barn. The case, *Teaff v. Hewitt*, reached the Supreme Court of Ohio and was decided in 1853, and the test the court wrote down is still quoted in law schools and on real estate exams across the country.

How they figured it out. English common law had long held that "whatever is attached to the soil becomes part of the soil," but that rule could not settle a factory full of bolted machines. Chief Justice Bartley wrote that a chattel becomes a **fixture** only when three things are true: it is actually annexed to the real estate; it is appropriated — adapted — to the use of the part of the realty it is connected to; and the person who attached it intended to make it a permanent addition to the land. Intention, the court said, is read from the item's nature, the way it is attached, its purpose, and the relationship of the person who attached it to the land. Applying that test, the court found that the heavy engine and boilers, bolted to timbers on foundations in the earth, were fixtures that belonged with the mortgaged land. But the carding machines, spinning machines and looms, fastened only to keep them steady and removable without injury to the building, remained personal property. Courts everywhere adopted the reasoning, later adding a fifth consideration that overrides the others: a written **agreement** between the parties.

The big idea. The law sorts all property into two kingdoms. **Real property** is land and everything permanently attached to it, together with the rights of ownership; **personal property** — the exam also says **chattels** or **personalty** — is everything movable. Be precise with three words the exam treats as a ladder. **Land** is the earth's surface, extending down to the center of the earth and up into the airspace, with its natural attachments such as trees and water. **Real estate** is land plus the permanent improvements people add — houses, fences, wells, driveways. **Real property** is real estate plus the *bundle of legal rights* that comes with owning it. Property crosses between kingdoms: **annexation** turns lumber into a deck (personal to real), and **severance** turns a standing tree into logs (real to personal). Each kingdom has its own transfer document — a **deed** for real property, a **bill of sale** for personal property.

To decide whether an item is a fixture, the national exam uses five tests, remembered as **MARIA**. **Method of attachment**: how permanently is it attached? Nailed, bolted, cemented or wired in suggests a fixture; removal that would damage the building strongly suggests one. **Adaptation**: was it made or fitted for this

particular property — custom storm windows, a built-in bookcase cut to an alcove, wall-to-wall carpet trimmed to the room? An item specially adapted is usually a fixture even if it is not physically attached, which is why house keys and the garage-door remote go with the house (sometimes called constructive annexation). **Relationship of the parties**: courts lean toward the buyer over the seller and toward the tenant over the landlord, so the same ceiling fan may be treated differently depending on who installed it. **Intention**: did the person who attached it intend a permanent addition? Intention, judged objectively from all the facts, is usually called the most important of the legal tests. **Agreement**: a written agreement between the parties controls over all the other tests. That is why a well-drafted purchase agreement lists inclusions and exclusions — "seller excludes the dining-room chandelier."

A **trade fixture** is equipment a commercial tenant attaches to rented space for use in the tenant's business: a bakery's ovens, a shoe store's shelving, a barber's chairs. Trade fixtures remain the tenant's personal property even though attached, because no tenant is presumed to intend a gift of its business equipment to the landlord. The tenant may remove them, but must do so before the lease expires and must repair any damage the removal causes. Trade fixtures that the tenant leaves behind after the lease ends become the landlord's property by **accession**. Notice how the relationship test works here: between landlord and commercial tenant, the law presumes the tenant's equipment is personal property. Farm tenants have a parallel protection for crops. Plants are divided into **fructus naturales** — "fruits of nature" such as trees, perennial bushes and pasture grass, which are part of the real property until cut — and **fructus industriales**, annual crops produced by labor, such as wheat, corn and potatoes. Annual crops are called **emblements** and are treated as personal property. A tenant farmer whose tenancy ends through no fault of the farmer — for example, when a life tenant landlord dies or an at-will tenancy is ended by the owner — may come back to harvest the crop he planted.

Several practical patterns follow. When real estate is sold, everything that is real property — the house, its fixtures, the trees, the fences — passes by the deed without being listed; personal property passes only if the parties agree and is commonly transferred by a separate bill of sale, sometimes with its own price. Growing crops on land being sold pass with the land unless the seller reserves them in writing. A **manufactured home** follows the two-kingdom rule closely: when it leaves the

factory it is personal property, usually titled like a vehicle, and it becomes real property only when it is permanently affixed to a foundation on land the owner holds and the owner completes the steps state law requires, such as surrendering the vehicle-style title. The details vary by state, so the licensee's rule is simple: when an item's status is unclear, put the answer in the contract. A listing agent who asks, before the first showing, "What are you taking with you?" prevents more disputes than any court ever settled.

On the exam today. Expect three or four questions from this lesson, usually as scenarios. The first trap is the vocabulary ladder: land is the earth and its natural attachments; real estate adds improvements; real property adds the bundle of rights. The second is the MARIA tests — be ready to name them and to recognize that a written agreement overrides every other test and that intention is the most important legal test when there is no agreement. The third is the trade fixture: it is personal property of the tenant, removable before the lease expires, and becomes the landlord's by accession if left behind. Watch for these distractors: "a fixture is personal property" (no — it was personal property before it was attached); "a tenant can remove trade fixtures any time after the lease ends" (no — before it ends); "crops always belong to the landowner" (annual crops are emblements, personal property); and "a bill of sale conveys the house" (a deed conveys real property). If a question asks how real property becomes personal, the answer is severance; the reverse is annexation.

PICTURE STUDY



Old Mill (The Morning Bell), Winslow Homer, 1871 · Oil on canvas · Yale University Art Gallery, New Haven, Connecticut

Image: Wikimedia Commons, public domain

Winslow Homer (1836–1910) began as an illustrator for *Harper's Weekly* and became one of America's great painters of ordinary working life. In 1871 he painted mill girls walking to work at a small New England textile mill at the sound of the morning bell — the same kind of building, with the same kind of machinery inside, that James Teaff and Samuel Hewitt's creditors fought over in Ohio. Homer shows only the outside, but every question in this lesson is hidden behind that mill door: is the waterwheel part of the land? the loom? the bell itself?

Look closely

- Follow the long plank walkway from the stone wall to the mill door. Is the walkway part of the real estate? Ask what holds it in place and whether it was built for this spot.
- Find the bell on the mill's roof. A bell hung in a frame atop a building is a classic example of a fixture: attached, adapted to the building and intended to stay.
- Look at the lunch pail in the young woman's hand. Nothing about it is attached to anything — it is the plainest kind of personal property in the picture.

- Notice the great tree beside the mill. Trees are fructus naturales — part of the land until someone severs them.

Talk about it

1. If this mill were sold tomorrow, list three things in or around it that would pass by the deed and one that would need a bill of sale.
2. Which of the five MARIA tests would matter most in deciding whether the looms inside belong to the buyer? Explain using what the Ohio court decided in 1853.
3. The mill workers walk to work at the bell, keeping a promise made by their labor. How is a seller who leaves the fixtures the buyer was promised also keeping faith, and why does that matter more than winning an argument at closing?

PROJECT

The Stays-or-Goes Inventory

Listing agents learn early that the costliest arguments in real estate are about small things — a chandelier, a mounted television, a garden shed. In this project you will build the inventory a careful agent prepares before a house ever goes on the market: every borderline item in a home, classified by the five tests, with a recommended line for the purchase agreement. Use your own home (or a relative's, with permission) as a pretend listing; no real sale is involved.

You will need

- Your exam notebook and a pencil
- Free spreadsheet software or a ruled sheet with six columns
- A tape measure or phone camera for noting how items are attached
- This lesson's MARIA tests and worked examples

Steps

1. Make six columns: Item, Room, Method of attachment, Adaptation, Your classification (fixture / personal / trade fixture / crop), Contract line.
2. Walk the whole property and list at least twenty items, choosing borderline ones: mounted televisions and brackets, curtain rods and curtains, mirrors, light fixtures, appliances, rugs and wall-to-wall carpet, built-in shelving, the mailbox, garden plants, a shed, the swing set.
3. For each, note exactly how it is attached (screws into studs, plugged in, resting by gravity, set in concrete) and whether it was custom-fitted to the house.
4. Classify each item, applying the tests in this order: Is there an agreement? If not, method, adaptation, relationship (seller vs. buyer) and intention.
5. Mark the five items most likely to cause a dispute, and for each write a one-sentence "inclusion" or "exclusion" line a seller could put in the purchase agreement.
6. Add a short section on the yard: list the fructus naturales (trees, shrubs, perennials) and any annual crops (a vegetable garden) and say who would

own each at a midsummer sale.

7. Finish with a paragraph on what you learned about the difference between the law's default answer and a written agreement.
8. Title the page "Stays or Goes — A Fixture Inventory," date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term in this lesson; put land, real estate and real property on one card as a three-step ladder, with each step adding one thing.
2. Draw a two-way arrow between two boxes labeled PERSONAL PROPERTY and REAL PROPERTY: write ANNEXATION on the arrow pointing to real property and SEVERANCE on the arrow pointing back, with two examples on each.
3. Write a trap list titled "Fixtures": (1) agreement beats every test; (2) intention is the most important legal test; (3) trade fixtures go before the lease ends, or they stay by accession; (4) emblements are personal property; (5) deed for real, bill of sale for personal.

> **From history.** The word "chattel" comes from the same old French root as "cattle." In medieval England a man's movable wealth was largely his livestock, so the word for cattle became the word for all movable goods — and real estate textbooks still use it. Land was different: it could not be driven to market, and disputes over it were settled by "real" actions, from the Latin *res*, a thing, which recovered the land itself rather than money. That is the origin of the word real in "real property."

Example 1. Exam style. A seller removes a custom-fitted set of wooden shutters from the house before closing, saying they "just lift off the hinges." The purchase agreement says nothing about them. Are the shutters most likely fixtures?

A. No, because they are not nailed or bolted

B. No, because the seller installed them

C. Yes, because they were specially adapted to the house

D. Yes, because all window coverings are fixtures

Show solution

1. Agreement first: the contract is silent, so the parties have not settled it, and the remaining tests decide.
2. Method of attachment: they hang on hinges and lift off — a weak sign of permanence by itself.
3. Adaptation: they were custom-made to fit these particular windows. An item specially fitted to the property is usually a fixture even without permanent attachment.
4. Relationship and intention: between a seller and a buyer the law leans toward the buyer, and a seller who orders custom shutters for the house shows an intention to improve the house, not to own portable shutters.
5. A ignores adaptation; B gets the relationship test backward; D overstates the rule — freestanding curtains on a tension rod, for example, are commonly personal property.

Answer: C. Adaptation and the buyer-favoring relationship test make custom-fitted shutters fixtures; the seller should have excluded them in writing.

Example 2. A bakery leases a storefront for five years and bolts two commercial ovens to the floor and wires them in. The lease is silent about the ovens. The lease expires on June 30. The baker returns on July 15 to remove them. Who owns the ovens, and why?

Show solution

1. Identify the relationship: commercial tenant and landlord. Equipment a tenant installs for its business is a trade fixture.
2. Rule: trade fixtures remain the tenant's personal property and may be removed — but only before the lease expires, with the tenant repairing any damage.
3. Timeline: the lease ended June 30; the baker did not remove the ovens before then.
4. Result: trade fixtures left behind after the lease ends become the landlord's property by accession.

Answer: The landlord owns them by accession. Had the baker removed them by June 30 and repaired the floor, they would have remained the baker's personal property.

Example 3. A farmer rents a field from Mrs. Lund, who holds a life estate. The farmer plants corn in April. Mrs. Lund dies in July, ending the tenancy. The remainderman says the corn is now his. Who may harvest it, and what about the apple orchard on the same field?

Show solution

1. Classify the corn: an annual crop produced by labor — fructus industriales, or emblements — personal property of the person who planted it.
2. Apply the emblements rule: the tenancy ended through no fault of the farmer (the life tenant's death), so the farmer may return to harvest the crop he planted.
3. Classify the apple trees: perennial plants are fructus naturales — part of the real property — and pass to the remainderman with the land.
4. The apples hanging on the trees go with the trees unless severed or reserved by agreement.

Answer: The farmer may harvest the corn as emblements; the orchard, being fructus naturales, belongs to the remainderman with the land.

PRACTICE

1. Easy What one thing does "real property" add to "real estate"?

   Show answer

   The bundle of legal rights of ownership. Land plus improvements is real estate; real estate plus the rights is real property.

2. Easy Name the five fixture tests represented by MARIA.

   Show answer

   Method of attachment, Adaptation, Relationship of the parties, Intention and Agreement. A written agreement controls over the others.

3. Easy A lumberjack fells a stand of timber on a farm. Has the timber changed from real to personal property, or the reverse, and what is the process called?

   Show answer

   From real to personal property, by severance. Standing trees are part of the land; cut logs are movable chattels.

4. **Medium** A homeowner buys a free-standing bookcase and later has a carpenter build it into an alcove with trim cut to fit the wall. Which two tests most clearly make it a fixture now?

   Show answer

   Method of attachment (it is now built in with trim) and adaptation (it was fitted to that particular alcove). Together they show an intention to make it a permanent part of the house.

5. **Medium** A restaurant tenant installed booths bolted to the floor. The lease ends December 31 and says nothing about the booths. On December 20 the landlord says, “Those are bolted down, so they’re mine.” Is the landlord right?

   Show answer

   No. Booths installed for the tenant’s business are trade fixtures and remain the tenant’s personal property; the tenant may remove them before December 31, repairing any damage. Only if they are left after the lease ends do they become the landlord’s by accession.

6. **Medium** Which of these is fructus naturales: wheat, a strawberry crop planted this spring, an oak tree, tomatoes?

   Show answer

   The oak tree. Trees and perennial plants that grow without annual cultivation are fructus naturales and part of the real property; the others are annual crops of labor — fructus industriales, or emblements.

7. **Medium** A seller wants to keep the mounted television but leave the wall bracket. What should the listing agent do, and why?

   Show answer

   Put it in writing: list the television as excluded personal property and the bracket as an included fixture in the purchase agreement. A written agreement controls over all the other tests and prevents a dispute at the final walk-through.

8. Hard A manufactured home sits on blocks on a rented lot, with its vehicle-style title still in force. A buyer receives a deed to the lot from the lot's owner. Does the deed convey the home?

Show answer

No. The home is still personal property — it is not permanently affixed to land owned by the home's owner and its title has not been converted under state law — so it must be transferred by its own title or bill of sale, not by a deed to someone else's land.

9. Hard A tenant installs a ceiling fan in an apartment; a homeowner installs an identical fan in his own house. Why might a court treat the two fans differently?

Show answer

The relationship test. A tenant is presumed not to intend a permanent gift to the landlord, so the tenant's fan may be removable; a homeowner who installs a fan is presumed to improve his own property, so it becomes a fixture that passes to his buyer.

10. Hard In *Teaff v. Hewitt* (1853), why did the court treat the steam engine and boilers differently from the looms and spinning machines?

Show answer

The engine and boilers were heavy, bolted to timbers on foundations in the earth and plainly meant to stay, so all three tests — annexation, adaptation and intention — pointed to fixtures. The looms and spinning machines were fastened only to keep them steady, could be removed without harm and were tied to the business rather than the building, so they remained personal property.

11. **Challenge** A seller's grandmother's crystal chandelier hangs in the dining room. The listing photos show it, the contract is silent, and the seller removes it the day before closing and hangs a cheap fixture in its place. Analyze the dispute and state what should have happened.

Show answer

The chandelier is wired into the ceiling and was shown as part of the house, so it is a fixture that passes to the buyer under the method, relationship and intention tests; substituting a cheaper fixture breaches the contract. The seller should have removed and replaced it before listing and photographing, or written a clear exclusion into the purchase agreement.

12. **Challenge** Explain in three sentences to a new seller why a written list of inclusions and exclusions is worth more than knowing the fixture tests.

Show answer

The five tests tell a court how to guess what the parties intended, and different courts weighing the same facts can guess differently. A written agreement removes the guessing, because the parties' own words control over every other test. A clear list costs a minute at the listing appointment and can save a lawsuit, a delayed closing and a broken friendship at the final walk-through.

COMMON MISTAKES

- Calling a fixture personal property — it was personal property before it was attached; once it is a fixture it is real property and passes with the deed.
- Thinking method of attachment decides everything — a written agreement overrides all the tests, and intention is usually the most important legal test.
- Letting a tenant remove trade fixtures after the lease ends — they must be removed before expiration, or they become the landlord's by accession.
- Treating all crops as real property — annual crops of labor (emblements, fructus industriales) are personal property; trees and perennials (fructus naturales) are real property.
- Mixing up the transfer documents — a deed conveys real property; a bill of sale conveys personal property.
- Assuming a manufactured home is always real property — it remains personal property until permanently affixed to the owner's land and converted under state law.

Make it a game · Stays or Goes?. One player is the seller's agent and calls out an item — "the porch swing hanging from hooks," "the window air conditioner," "the tenant baker's oven," "the rose bushes," "a sack of potatoes harvested this morning." Everyone else slaps the table and shouts STAYS or GOES, then the fastest player must name the MARIA test that decides it. A correct call and test earns two points; a correct call with the wrong test earns one. Twice per round the caller may add a twist ("...and the contract excludes it") — whoever remembers that agreement beats every test earns a bonus point. Play to fifteen.

Scripture. "Therefore whosoever heareth these sayings of mine, and doeth them, I will liken him unto a wise man, which built his house upon a rock: And the rain descended, and the floods came, and the winds blew, and beat upon that house; and it fell not: for it was founded upon a rock." (Matthew 7:24–25, KJV)

The Lord's parable turns on what is fixed and what is not: the wise man's house stands because it is joined to the rock. The law of fixtures asks the same question about everything in a house — what has been made part of the foundation, and what merely rests there. A life, like a house, is tested by what it is truly attached to.

1.2 Why Land Is Different: The Characteristics of Real Property

OBJECTIVES

- Name and define the three physical characteristics of land: immobility, indestructibility and uniqueness (nonhomogeneity).
- Name and define the four economic characteristics: scarcity, improvements (modification), permanence of investment (fixity) and area preference (situs).
- Classify a scenario by the characteristic it illustrates, telling physical from economic traits.
- List the five rights in the bundle of rights — possession, control, enjoyment, exclusion and disposition — and give an example of each.
- Distinguish improvements to land from improvements on land, and explain why uniqueness makes specific performance available in real estate contracts.

> **Warm-up.** Write down the price of something you could buy in any store in the country — a gallon of milk, a pair of shoes. Then think of two houses you know that are nearly identical but in different towns. In five minutes, write three reasons why the milk costs about the same everywhere but the two houses might differ in price by a great deal.

WATCH

Characteristics of Real Property | Real Estate License Exam

Blue Card Prep Academy · 11:01

https://www.youtube.com/watch?v=tRe0zWix71U

> **WHEN TO WATCH**
> Watch after the core ideas; stop at the quiz near the end and answer each question aloud before the video reveals it, then check yourself against the notebook table you drew.

BACKUP VIDEO

7 Characteristics of Real Property: Physical & Economic | NC Real Estate Exam Prep

Tar Heel Real Estate Exam Prep · 3:59

https://www.youtube.com/watch?v=cRXvVzCD6aA

A four-minute review of the same seven traits — watch it on practice day and recite the list before the video does.

KEY TERMS

immobility

The physical characteristic that land cannot be moved; its geographic location is fixed, though some of its substances can be removed.

indestructibility

The physical characteristic that land is permanent and cannot be destroyed, although the improvements on it can be.

uniqueness

The physical characteristic that no two parcels of land are exactly alike, at least in location; also called nonhomogeneity or heterogeneity.

scarcity

The economic characteristic that the supply of land in any given area is limited, which supports its value.

improvements

The economic characteristic that building on or modifying one parcel affects its value and the value of surrounding parcels; also called modification.

area preference

The economic characteristic — also called situs — that people prefer some locations over others, which makes location the most important factor in value.

improvement

Any man-made addition that increases a property's usefulness — on the land (a building, a fence) or to the land (streets, sewers, utilities).

permanence of investment

The economic characteristic that capital invested in land and buildings is fixed in place for a long time and is recovered slowly; also called fixity.

bundle of rights

The legal rights of ownership: possession, control, enjoyment, exclusion and disposition.

specific performance

A court order requiring a party to carry out a contract as agreed, available in real estate because each parcel is unique and money damages cannot replace it.

CORE IDEAS

The story. In the small hours of March 30, 1867, Secretary of State William H. Seward and the Russian minister, Baron Eduard de Stoeckl, signed a treaty in Washington by which the United States bought Russian America for $7,200,000 in gold. The land measured nearly 600,000 square miles — more than twice the size of Texas — and the price worked out to about two cents an acre. Many newspapers mocked the deal. They called the territory "Seward's Folly" and "Seward's Icebox," a frozen waste no one would ever want. Seward saw something else: land that could never be moved, never be destroyed and never be duplicated, in a place no other nation could ever again offer for sale. The flag was raised at Sitka on October 18, 1867. Within thirty years, gold strikes at Juneau, the Klondike rush through Alaska's ports and the beaches of Nome had made the purchase look shrewd; a century later the oil of Prudhoe Bay made it look like genius. The ground had not changed at all. What changed was what people knew about it and how badly they wanted to be there.

How they figured it out. Economists and appraisers spent the following century trying to explain why land behaves so differently from wheat, cotton or steel. A bushel of wheat is like every other bushel of its grade, can be shipped to whoever pays the most and is used up when eaten. Land is none of these things. Writers on land economics in the early twentieth century sorted the differences into two groups, and real estate textbooks have taught the same list ever since. The first group is **physical characteristics** — facts about the land itself that are true whether or not anyone wants it: it cannot be moved, it cannot be destroyed, and no two parcels are alike. The second group is **economic characteristics** — facts about how people value land: it is scarce, its value is changed by improvements, money invested in it is fixed for a long time, and people prefer some locations to others. The physical traits explain why land markets are local and slow; the economic traits explain why prices move. Alaska showed every one of them in a single story.

The big idea. Memorize three physical and four economic characteristics. **Immobility**: the geographic location of land never changes. Soil, minerals and water can be carried away, but the parcel itself stays put — which is why every real estate market is local and why land is regulated and taxed where it lies. **Indestructibility**: land is permanent. A fire, flood or earthquake can destroy the house, but the land remains, which is why insurers insure buildings and not land, and why appraisers depreciate buildings but never land. **Uniqueness**, also called **nonhomogeneity** or heterogeneity: no two parcels are identical, if only because no two occupy the same spot on earth. Two tract houses built from the same plans still differ in location, view and neighbors. Uniqueness is why the law treats a contract to buy land differently from a contract to buy a car: if a seller refuses to close, a court can order **specific performance**, forcing the sale, because no amount of money can buy the buyer another parcel exactly like it.

The economic characteristics explain value. **Scarcity**: the total supply of land is fixed, and the supply of land in a particular desirable area is limited. Scarcity is relative — there is plenty of land in the world, but not plenty of lots within walking distance of a good school, so prices rise where demand presses on a limited supply. **Improvements**, also called **modification**: building on or changing one parcel affects its value and the value of its neighbors. A new park can raise nearby values; a landfill can lower them. **Permanence of investment**, also called **fixity**: money spent on land, buildings, roads and sewers is committed for decades and is recovered slowly

through use, rent or eventual sale. This is why real estate is called an illiquid investment — it cannot be turned into cash quickly at full value. **Area preference**, also called **situs**: people prefer some locations over others for reasons of convenience, safety, beauty, schools and prestige. Area preference is the economic heart of the old saying that the three most important things in real estate are location, location and location.

The exam also asks you to tell two kinds of **improvements** apart. An improvement *on* the land is a structure built on a parcel: a house, garage, barn or fence. An improvement *to* the land is work that makes land usable for building: streets, curbs, sidewalks, sewer and water lines, street lights and utilities — often called infrastructure or off-site improvements. A developer who brings water and roads to raw acreage has improved the land itself before a single house goes up. Both kinds are part of the real estate, and both connect to the fixity characteristic: a city's sewer line and a family's foundation are both money buried in place for generations. Notice, too, which characteristic explains a given fact. Why do appraisers depreciate only buildings? Indestructibility of land. Why does a buyer get specific performance? Uniqueness. Why are there no national real estate prices? Immobility. Why did a new highway interchange raise farm values? Improvements and area preference working together.

Ownership itself is described as a **bundle of rights**, like a bundle of sticks that can be held together or separated. The five standard rights are **possession** (the right to occupy and hold the property), **control** (the right to use and alter it within the law — to paint, plant or build), **enjoyment** (the right to use it without interference from others, sometimes called quiet enjoyment), **exclusion** (the right to keep others out) and **disposition** (the right to sell, give, lease, mortgage or will it to someone else). An owner can hand out sticks one at a time: a lease transfers possession for a term while the owner keeps disposition; a mortgage pledges the property while the owner keeps possession; an easement lets a neighbor cross the land, limiting exclusion. The bundle is never unlimited — the government's police power, eminent domain, taxation and escheat sit above every private owner, as Unit 3 explains — but it is the most complete set of rights the law allows a private person to hold.

On the exam today. Expect two or three classification questions: a scenario is described and you must name the characteristic. The traps are predictable. First, physical versus economic: immobility, indestructibility and uniqueness are *physical*;

scarcity, improvements, permanence of investment and area preference are *economic*. A question asking which is NOT a physical characteristic usually offers scarcity or situs as the answer. Second, synonyms: nonhomogeneity and heterogeneity mean uniqueness; situs means area preference; fixity means permanence of investment; modification means improvements. Third, location: "the most important factor affecting value" is area preference (location), an economic characteristic, even though the fact that land cannot move is the physical one. Fourth, the bundle: know all five rights, and know that a lease transfers possession, not disposition. Finally, remember that specific performance is available because of uniqueness, and that land is not depreciated because it is indestructible.

PICTURE STUDY



The Signing of the Alaska Treaty, Emanuel Leutze, 1867 · Oil on canvas · William H. Seward House Museum, Auburn, New York

Image: Wikimedia Commons, public domain

Emanuel Leutze (1816–1868), the German-American painter best known for *Washington Crossing the Delaware*, painted this scene in 1867, within months of the treaty it imagines. Seward sits at the left of center with a map across his knees; the Russian minister, Baron de Stoeckl, stands with his hand on the globe, pointing to the land being sold. The painting opens this lesson because it shows land being bought by people who could not move it, could not see most of it, and could not get another like it — immobility, uniqueness and scarcity, all at one table.

Look closely

- Find the globe at the center. Why do you think the painter made it the largest object in the room, larger than any of the men?
- Look at Seward's face and posture compared with the standing men. What does Leutze suggest about who was sure of this purchase and who was not?
- Notice the papers and maps in several hands. Even a treaty for 600,000 square miles depended on a description of the land on paper — the subject of the next two lessons.
- Count the candles and lamps. The treaty was signed in the middle of the night; the painter keeps the room lit as if for a vigil.

Talk about it

1. Which of the seven characteristics of land would Seward's critics in 1867 have pointed to, and which did later events prove they had underestimated?
2. Explain how area preference can change while immobility and indestructibility stay exactly the same. Use Alaska as your example.
3. Seward was mocked for years for a judgment that later proved wise. What does it take to make a sound decision patiently and endure being misunderstood, and where does Scripture commend that kind of steadiness?

PROJECT

The Seven Characteristics Field Guide

Every characteristic of land in this lesson can be seen from a car window, if you know what to look for. In this project you will build a one-page field guide to your own town: for each of the seven characteristics, a real local example, photographed or sketched, with a sentence explaining it. Agents who can explain why a street commands a premium are agents clients trust.

You will need

- Your exam notebook and a pencil
- A phone camera or sketchbook
- A paper or online map of your town
- Your county assessor's online parcel map (free and public)

Steps

1. Draw a table with seven rows (immobility, indestructibility, uniqueness, scarcity, improvements, permanence of investment, area preference) and three columns (local example, photo or sketch, one-sentence explanation).
2. Find a local example of each: a lot where a building burned or was torn down but the land remains (indestructibility); two similar houses with different views or settings (uniqueness); the most sought-after street in town (area preference); a new road, park or sewer project (improvements).
3. On the assessor's parcel map, look up the land value and improvement value of two parcels of similar size in different neighborhoods. Record both numbers, labeled "public assessor figures, used as examples," and explain the difference using one characteristic.
4. Mark one improvement to the land (a street, utility line or sidewalk) and one improvement on the land (a building) and label which is which.
5. Write a short paragraph naming the single characteristic that most explains prices in your town, with evidence.
6. Title the page "The Seven Characteristics — Field Guide to [Your Town]," date it and add it to your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the seven characteristics, with the synonyms on the back: uniqueness = nonhomogeneity = heterogeneity; area preference = situs; permanence of investment = fixity; improvements = modification.
2. Draw a two-column table, PHYSICAL (immobility, indestructibility, uniqueness) and ECONOMIC (scarcity, improvements, permanence of investment, area preference), with one picture-sized example under each item.
3. Draw a bundle of five sticks tied with string and label each stick: possession, control, enjoyment, exclusion, disposition; beside it write which stick a lease hands to a tenant.

> **From history.** The Alaska check itself survives. The United States paid with a Treasury warrant dated August 1, 1868, for $7,200,000 in gold, made out to the Russian minister, and it is kept today in the National Archives. Congress took more than a year to appropriate the money, and some members argued against paying at all. The delay meant the flag had flown over Sitka for nearly ten months before the land was actually paid for — an early lesson that title and payment do not always move together.

Example 1. Exam style. Two identical houses built by the same builder from the same plans sell for very different prices because one backs onto a park and the other onto a freeway. This BEST illustrates:

A. Indestructibility

B. Immobility

C. Area preference

D. Permanence of investment

Show solution

1. Identify the cause of the price difference: not the houses (they are identical) but where they are and what surrounds them.
2. People prefer the park side to the freeway side — preference for one location over another is area preference, or situs.
3. B is tempting, because the houses cannot be moved, but immobility is the physical fact; the price difference comes from people's preference, an economic characteristic.
4. A and D do not explain a price difference between identical houses.

Answer: C. Area preference (situs) — the economic characteristic behind the saying "location, location, location."

Example 2. A seller signs a contract to sell a lakefront cabin, then receives a higher offer and refuses to close. The buyer sues and asks the court to order the sale rather than award money. Which characteristic of land supports the buyer's request, and what is the remedy called?

Show solution

1. Ordinary contract breaches are remedied with money damages.
2. A buyer of land can ask for more because no other parcel is exactly like this one — the physical characteristic of uniqueness (nonhomogeneity).
3. Because money cannot buy a substitute, courts may order the seller to perform the contract as written.
4. That remedy is specific performance.

Answer: Uniqueness (nonhomogeneity) supports the remedy of specific performance, a court order compelling the seller to complete the sale.

Example 3. Sort these facts by characteristic: (1) a tornado destroys a barn but the farm remains; (2) the county extends a sewer line and nearby acreage rises in value; (3) investors cannot sell an office building quickly at full value during a downturn; (4) the price of lots near the only bridge across the river keeps rising.

Show solution

1. Fact 1: the land survives the loss of the improvement — indestructibility (physical).
2. Fact 2: a public improvement changes the value of surrounding land — improvements, or modification (economic). The sewer line is an improvement to the land.
3. Fact 3: money is locked in place and recovered slowly — permanence of investment, or fixity (economic).
4. Fact 4: few lots in a much-wanted place — scarcity, reinforced by area preference (both economic).

Answer: (1) indestructibility; (2) improvements; (3) permanence of investment; (4) scarcity, with area preference.

PRACTICE

1. Easy List the three physical characteristics of land.

Show answer

Immobility, indestructibility and uniqueness (nonhomogeneity). They describe the land itself, whether or not anyone wants it.

2. Easy What is another name for area preference?

Show answer

Situs. It is the economic characteristic that people prefer some locations to others, and it is the main reason location drives value.

3. Easy Name the five rights in the bundle of rights.

Show answer

Possession, control, enjoyment, exclusion and disposition.

4. Medium Why do appraisers depreciate buildings but never the land under them?

Show answer

Because land is indestructible. Buildings wear out and lose value with age, but the land itself is permanent and does not wear out.

5. Medium Is scarcity a physical or an economic characteristic? Explain why the distinction matters on the exam.

Show answer

Economic. The exam often asks which item is NOT a physical characteristic, and scarcity (or situs) is the usual answer, because scarcity depends on how much people want land in a place rather than on the land itself.

6. Medium A city builds a new light-rail station, and homes within a half-mile rise in value. Name two characteristics at work.

Show answer

Improvements (modification) — a public improvement changed surrounding values — and area preference, because buyers now prefer locations near the station.

7. Medium Give one example of an improvement to the land and one of an improvement on the land.

Show answer

To the land: a sewer line, street, curb or utility connection. On the land: a house, garage, fence or barn.

8. Hard An owner leases her house to a tenant for a year. Which stick in the bundle passes to the tenant, and which important stick does the owner keep?

Show answer

Possession passes to the tenant for the term (along with use and enjoyment during the lease). The owner keeps disposition — she may still sell or mortgage the property, subject to the lease.

9. Hard Explain why there is no single national price for a three-bedroom house, using the correct physical characteristic.

Show answer

Immobility. Because land cannot be moved to where demand is highest, each local market sets its own prices; a house in one town cannot be shipped to another town where it would sell for more.

10. Hard Which characteristic makes real estate an illiquid investment, and what does illiquid mean?

Show answer

Permanence of investment (fixity). Money invested in land and buildings is fixed in place and recovered slowly, so the investment cannot be quickly turned into cash at full value — that is what illiquid means.

11. **Challenge** Using the Alaska Purchase, explain how land can be bought for two cents an acre and later be called a bargain at that price, naming at least three characteristics.

Show answer

The land was immobile and indestructible, so it stayed exactly where it was and survived every change in opinion; it was unique, so no other nation could offer the same territory. What changed was economic — discoveries of gold and later oil raised area preference and revealed scarcity of such resources — so value rose while the land itself stayed the same.

12. **Challenge** A buyer's friend says, "If the seller backs out, just take the money damages and buy another house." Write two sentences explaining why the law gives a real estate buyer a stronger remedy.

Show answer

Every parcel of land is unique, so no amount of money can buy the buyer another property exactly like the one under contract. For that reason courts may order specific performance, compelling the seller to complete the sale as agreed.

COMMON MISTAKES

- Calling scarcity or area preference a physical characteristic — both are economic; the physical three are immobility, indestructibility and uniqueness.
- Confusing immobility with area preference — immobility is the physical fact that land cannot move; area preference is people's economic preference for some locations.
- Forgetting the synonyms — nonhomogeneity means uniqueness, situs means area preference, fixity means permanence of investment, modification means improvements.
- Saying land depreciates — buildings depreciate; land is indestructible.
- Thinking a lease transfers disposition — a lease transfers possession for a term; the owner keeps the right to sell, mortgage or will the property.
- Calling a street or sewer an improvement "on" the land — infrastructure is an improvement to the land; buildings are improvements on it.

Make it a game · Physical or Economic?. Write the seven characteristics on seven index cards and spread them face up. One player reads a scenario aloud — "a flood ruins the house but the lot is still there," "the only beach lots in the county," "a new freeway exit," "two tract houses on different streets sell for different prices." The first player to slap the right card keeps the scenario as a point, but must also say PHYSICAL or ECONOMIC; getting that wrong gives the point away. After ten scenarios, play a lightning round of synonyms — the caller says "situs," "fixity," "nonhomogeneity," "modification" — and players race to touch the matching card.

Scripture. "The land shall not be sold for ever: for the land is mine; for ye are strangers and sojourners with me." (Leviticus 25:23, KJV)

Every characteristic of land in this lesson points past the owner: land outlasts every deed, stays where it is when its owners are gone, and cannot be made again. Israel was taught that the true owner of the land is God, and that every human owner holds it for a time. A real estate professional handles something that will be there long after the transaction — a good reason to handle it with care and humility.

1.3 Metes and Bounds: Walking the Line

OBJECTIVES

- Explain why a street address is not a legal description and state what a legal description must allow a surveyor to do.
- Read and write a metes-and-bounds description using a point of beginning, courses (bearings), distances and monuments, and test it for closure.
- Convert among feet, links, rods, chains and miles, and compute acreage from square feet.
- Distinguish natural from artificial monuments and state which controls when a description conflicts.
- Define survey, plat, benchmark and datum, and explain how a survey reveals encroachments.

> **Warm-up.** Without naming any street or building, write directions that would let a stranger find one corner of your yard and walk its whole boundary. You may use a compass direction, a number of steps and anything you can see. Trade with someone and let them try to follow it. Where did your description fail?

WATCH

Metes and Bounds: What You Need To Know | Real Estate Exam Prep - PrepAgent

PrepAgent · 6:44

https://www.youtube.com/watch?v=8AI1kersOsk

> **WHEN TO WATCH**
> Watch after reading the story and the big idea; when the video shows its sample description, sketch the parcel in your notebook as it reads each course, then check that your drawing closes.

BACKUP VIDEO

A-Ha! Real Estate Exam Prep: Legal Descriptions: Metes & Bounds

A-Ha! Real Estate Exam Prep · 4:58

https://www.youtube.com/watch?v=HeoeqnS4lgk

Watch on practice day if bearings still confuse you; draw each bearing on your compass-rose sketch as the instructor names it.

KEY TERMS

legal description

A description of land, recognized by law, that is complete enough for a competent surveyor to locate the parcel exactly; the three methods are metes and bounds, the rectangular survey and lot and block.

metes and bounds

A method of legal description using measurements (metes) and boundaries (bounds), running from a point of beginning around the parcel by courses and distances and back to the point of beginning.

point of beginning (POB)

The fixed starting point of a metes-and-bounds description, to which the description must return to close.

course

The direction of a boundary line, stated as a bearing measured from north or south toward east or west — for example, N 45° E.

monument

A fixed natural or artificial object used to mark a boundary or corner — a tree, river or rock (natural), or an iron pin, concrete marker or fence (artificial).

Gunter's chain

The surveyor's chain of 100 links measuring 66 feet; 80 chains make a mile and 10 square chains make an acre.

rod

A unit of length equal to 16½ feet, also called a pole or perch; four rods make one chain.

survey

The process of measuring and marking land boundaries, and the map (survey drawing) that results, prepared by a licensed land surveyor.

plat

A map of land showing its boundaries, dimensions and divisions, such as the lots and blocks of a subdivision, often recorded in public records.

benchmark

A permanent reference mark, usually a metal disk set in concrete or rock, whose elevation above a datum has been precisely measured.

datum

A point, line or surface — such as mean sea level — from which elevations and depths are measured.

encroachment

A building, fence or other improvement that extends onto a neighbor's land; it is revealed by a survey, not by a title search.

CORE IDEAS

The story. On July 20, 1749, a tall seventeen-year-old named George Washington received a commission from the College of William and Mary as the official surveyor of Culpeper County, Virginia. He had already spent a spring in the Shenandoah Valley helping survey the vast lands of Lord Fairfax, sleeping in the open and learning the trade from older men. Now he worked on his own. With a surveyor's compass called a circumferentor and a 66-foot iron chain carried by two chainmen, he walked the boundaries of frontier tracts in Frederick County and beyond, recording each line by its direction and its length in "poles," and marking corners on trees, rocks and stakes. In April 1750 he surveyed 460 acres on the Cacapon River for a settler named William Hughes Jr., tying it to a corner of Hughes's father's land and recording lines such as "N 73° W 320 poles" around the parcel. Washington completed many surveys in his first three years, and his fees bought his first land. The founder of a nation began as a young man who could walk a line and write it down so that anyone, anytime, could walk it again.

How they figured it out. In colonial America there was no grid. Land was granted in irregular tracts that followed rivers, ridges and older claims, and the only way to describe such a tract was to walk its edge. English surveyors had inherited a method centuries old: start at a fixed point, record the direction of each boundary line and its length, mark the corners with something that will last, and come back to where you started. In 1620 an English mathematician, Edmund Gunter, gave the method its unit — a chain of 100 links measuring exactly 66 feet. Gunter's chain was brilliant for land: 10 square chains make an acre and 80 chains make a mile, so a surveyor could compute area without fractions. The method, called **metes and bounds**, became the law of land description in the original thirteen states and in several states settled before the federal survey, such as Kentucky, Tennessee and Texas. It still governs millions of parcels today, and it is the method surveyors use for any irregular tract anywhere in the country.

The big idea. A **legal description** identifies land so precisely that a competent surveyor could find it without any other help. A street address is not a legal description: streets are renamed and renumbered, and an address says nothing about where the boundary lines run. Deeds, mortgages and many contracts therefore use one of three methods — metes and bounds (this lesson), the rectangular survey and lot and block (the next lesson). In **metes and bounds**, *metes* are measurements of distance and direction and *bounds* are boundaries marked by monuments. Every description has the same parts. It starts at a **point of beginning** (POB), a fixed, identifiable spot. It then runs a series of **courses** and distances — "thence North 45 degrees East 200 feet to an iron pin" — and it must end by returning to the point of beginning. A description that does not return to the POB fails to **close**: it does not enclose any area, and the description is defective.

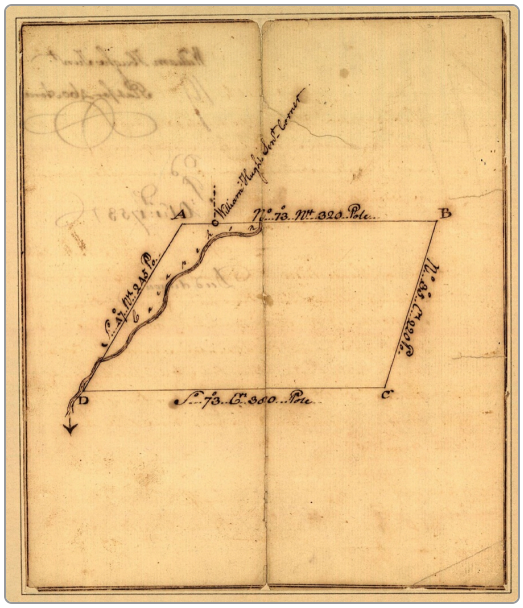
Courses are written as **bearings**. Each bearing begins with north or south, gives an angle of 0 to 90 degrees, and ends with east or west. N 45° E means: face north, then turn 45 degrees toward the east. S 30° W means: face south, then turn 30 degrees toward the west. A bearing never starts with east or west and never exceeds 90 degrees. Degrees divide into 60 minutes and minutes into 60 seconds, so a precise course reads like N 27° 14′ 30″ E. Reversing a line reverses both letters: a line that runs N 45° E from A to B runs S 45° W from B to A. Boundaries are marked by **monuments**, which may be *natural* — a river, a large rock, an old oak — or *artificial* — an iron pin, a concrete marker, a fence, a road. Because the people who made the deed could see the monuments, courts give them priority when a description conflicts with itself: monuments generally control over courses, and courses control over distances. If a deed says "thence 200 feet to the white oak" and the oak is 204 feet away, the line runs to the oak.

Surveyors' old units still appear on exams. A **Gunter's chain** is 66 feet, made of 100 **links** of 7.92 inches each. A **rod** — also called a pole or perch — is 16½ feet, and 4 rods make a chain. A mile is 5,280 feet, which is 80 chains or 320 rods. For area, an **acre** is 43,560 square feet, which is also 10 square chains (66 × 660 feet) or 160 square rods. To convert, divide feet by 66 for chains or by 16.5 for rods, and divide square feet by 43,560 for acres. Washington's 320 poles, in this example, were 320 rods: $320 \times 16.5 = 5{,}280$ feet, exactly one mile. Modern descriptions use feet and decimal feet, but older deeds — and the exam — still speak in chains and rods, and a licensee must be able to translate them.

A **survey** is the measurement and marking of land boundaries by a licensed land surveyor, and the drawing that records the work. The surveyor locates monuments, measures lines and angles, sets new corner pins where needed and shows the buildings, fences, driveways and easements in relation to the boundaries. That last part is why buyers and lenders order surveys: a survey reveals **encroachments** — a neighbor's garage two feet over the line, a fence built in the wrong place — that a title search of the public records will never show. Surveyors also measure height. Elevations are stated relative to a **datum**, a reference surface such as mean sea level, and are carried across the country by **benchmarks**, permanent metal disks set in rock or concrete with precisely measured elevations; the National Geodetic Survey maintains the national network. Elevations matter for flood zones, for condominium air lots and for any description of land above or below the surface. Finally, a **plat** is a surveyed map of land showing its boundaries and divisions; when a subdivision plat is recorded, its lots and blocks become a legal description of their own, as the next lesson shows.

On the exam today. Expect two or three questions from this lesson. The most common asks what a metes-and-bounds description must do: start at a point of beginning and return to it. The second tests vocabulary: metes are measurements, bounds are boundaries, monuments are natural or artificial markers, and a street address is not a legal description. The third is a conversion: a chain is 66 feet, a rod 16½ feet, a mile 5,280 feet, an acre 43,560 square feet. Traps to watch: "the description ends at the last monument" (no — it must return to the POB); "a bearing of E 45° N" (not a valid bearing — bearings start with N or S); "a rod is 66 feet" (that is a chain); and "a title search reveals encroachments" (a survey does). If a question asks which method describes land by courses and distances from a point of beginning, the answer is metes and bounds — never the rectangular survey, which uses meridians and base lines.

PICTURE STUDY



Plat of a Survey for William Hughes, Jr., of 460 Acres on the Cacapon River, George Washington, 1750 · Pen and ink on paper · Library of Congress, Geography and Map Division, Washington, D.C.
Image: Wikimedia Commons, public domain

This plat was drawn by George Washington himself, at eighteen, from survey notes he signed on April 4, 1750. It comes from his earliest years as a professional surveyor in the Virginia backcountry, and the Library of Congress preserves it among his papers. It opens this lesson because it is a metes-and-bounds description you can actually see: four corners lettered A to D, each side marked with a bearing and a distance in poles, a river cutting through the tract, and a starting corner tied to a neighbor's land.

Look closely

- Find corner A and the small circle beside it marking "William Hughes Senr. Corner." That is how the young surveyor tied his point of beginning to a monument others already knew.
- Read the top line: "N 73 W 320 Pole." Translate it: a bearing of north 73 degrees west, for 320 poles (rods) — exactly one mile.
- Follow the four sides around from A to B to C to D and back to A. Does the tract close?
- Trace the Cacapon River across the parcel. A natural monument like a river helped later surveyors find these lines again.

Talk about it

1. Compute the length of the line from A to B in feet, and explain how you know the answer is one mile.
2. If the river shifted course over the next fifty years, why would the bearings and distances still matter? Which would a court favor if they conflicted with a monument?
3. Washington's surveys were trusted because he walked every line honestly and recorded what he found. Why does a boundary drawn by an honest surveyor protect both neighbors, and what does Scripture say about the one who moves a landmark?

PROJECT

Walk the Line: A Metes-and-Bounds Description of a Real Lot

In this project you will do what Washington did, on a small scale: measure a real piece of ground, write its metes-and-bounds description and test it for closure. Use your own yard, a church lot or a park corner with permission. Then you will find a real recorded description in your county's public records and translate its old units.

You will need

- A 50- or 100-foot tape measure, or a measured pace (count your steps over 100 feet first)
- A compass or phone compass app
- Graph paper, ruler, protractor and pencil
- Your county recorder's or assessor's website (free and public)

Steps

1. Pick a four-sided area with clear corners. Choose a point of beginning you could find again — a fence corner, a utility box — and describe it in one sentence.
2. At each corner, take a compass reading toward the next corner and convert it to a bearing (for example, a reading of 135° becomes S 45° E). Measure each side in feet.
3. Write the full description in proper form: "Beginning at…; thence [bearing] [distance] feet to [monument]; thence…; to the point of beginning."
4. Plot it to scale on graph paper (for example, 1 inch = 20 feet). Measure how far your last line misses the point of beginning; that gap is your closure error. Explain in two sentences where it likely came from.
5. Compute the area in square feet and acres, and convert each side to rods and chains.
6. On your county's public records site, find any recorded subdivision plat or deed with a metes-and-bounds description. Copy one course and distance only (no owner names) and translate it into plain English.

7. Title the page “Walk the Line,” date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Flashcards for every key term, plus a conversion card: chain 66 ft = 4 rods = 100 links; rod 16½ ft; mile 5,280 ft = 80 chains = 320 rods; acre 43,560 sq ft = 10 square chains = 160 square rods.
2. Draw a compass rose and mark four sample bearings on it — N 45° E, S 30° E, S 60° W, N 10° W — with arrows; under it write “bearings start with N or S, never exceed 90°.”
3. Write a trap list titled “Metes and Bounds”: must return to the POB; monuments beat courses, courses beat distances; a street address is not a legal description; a survey, not a title search, reveals encroachments.

KEY FORMULAS

$$1 \text{ chain} = 66 \text{ ft} = 4 \text{ rods} = 100 \text{ links}$$

$$1 \text{ rod} = 16.5 \text{ ft}$$

$$1 \text{ mile} = 5{,}280 \text{ ft} = 80 \text{ chains} = 320 \text{ rods}$$

$$1 \text{ acre} = 43{,}560 \text{ sq ft} = 10 \text{ square chains} = 160 \text{ square rods}$$

$$\text{acres} = \frac{\text{square feet}}{43{,}560}$$

From history. Edmund Gunter (1581–1626), who designed the 66-foot chain, was an English clergyman and professor of astronomy at Gresham College in London. His chain fit England’s older measures perfectly: four rods to a chain, ten chains to a furlong, eight furlongs to a mile. The word furlong itself comes from “furrow long,” the length of a plowed furrow in an open field. American surveyors carried Gunter’s chains across the continent, and the Public Land Survey used them until steel tapes replaced them in the late nineteenth century.

WORKED EXAMPLES

Example 1. An old deed describes a line as running "40 rods" and another as "12 chains." Convert both to feet.

Show solution

1. A rod is 16.5 feet: $40 \times 16.5 = 660$ ft.
2. A chain is 66 feet: $12 \times 66 = 792$ ft.
3. Check with the chain-rod relationship: 40 rods ÷ 4 = 10 chains, and $10 \times 66 = 660$ ft — the same answer.

Answer: 40 rods = 660 feet; 12 chains = 792 feet.

Example 2. Exam style. A rectangular tract measures 10 chains by 20 rods. How many acres does it contain?

A. 2 acres

B. 5 acres

C. 10 acres

D. 20 acres

Show solution

1. Convert both sides to feet: $10 \times 66 = 660$ ft and $20 \times 16.5 = 330$ ft.
2. Area: $660 \times 330 = 217{,}800$ sq ft.
3. Acres: $\dfrac{217{,}800}{43{,}560} = 5$ acres.
4. Shortcut: 20 rods = 5 chains, so the tract is 10 × 5 = 50 square chains, and 10 square chains make an acre — 5 acres.

Answer: B. 5 acres.

Example 3. A description reads: “Beginning at the iron pin at the northwest corner of the Riley tract; thence N 90° E 300 feet to a stone; thence S 0° E 200 feet to an oak; thence S 90° W 300 feet to a fence post.” What is wrong with it, and how would you fix it?

Show solution

1. Trace it: east 300 feet, south 200 feet, west 300 feet. The parcel has three sides drawn and ends at a fence post 200 feet south of the start.
2. A metes-and-bounds description must return to the point of beginning. This one does not close, so it does not enclose any land.
3. Add the closing call: “thence N 0° E 200 feet to the point of beginning.”
4. With four courses, the tract is a rectangle of $300 \times 200 = 60{,}000$ sq ft, or $60{,}000 \div 43{,}560 \approx 1.38$ acres.

Answer: The description fails to close; adding a final course back to the point of beginning fixes it and encloses about 1.38 acres.

PRACTICE

1. Easy What do the words “metes” and “bounds” mean?

   Show answer

   Metes are measurements (distances and directions); bounds are boundaries, usually marked by monuments.

2. Easy How many feet are in a rod, and how many in a chain?

   Show answer

   A rod is 16½ feet; a chain is 66 feet, or 4 rods.

3. Easy Why is a street address not a legal description?

   Show answer

   An address does not show where the boundary lines run and can change if streets are renamed or renumbered; a legal description must let a surveyor locate the exact boundaries.

4. **Medium** A line runs N 60° E from corner A to corner B. What is its bearing from B back to A?

Show answer

S 60° W. Reversing a line reverses both letters and keeps the angle.

5. **Medium** How many acres are in a square tract 660 feet on each side?

Show answer

$660 \times 660 = 435{,}600$ sq ft; $435{,}600 \div 43{,}560 = 10$ acres. (660 feet is 10 chains, and 10 × 10 = 100 square chains, which is 10 acres.)

6. **Medium** Give two examples of natural monuments and two of artificial monuments.

Show answer

Natural: a river, a large rock, a tree. Artificial: an iron pin, a concrete marker, a fence or a road.

7. **Medium** A buyer's title search is clean, but the neighbor's new shed sits three feet onto the buyer's lot. What would have revealed the problem?

Show answer

A survey. Encroachments are physical facts on the ground and are not shown in the public records a title search examines.

8. **Hard** A deed calls for a line "N 20° E 400 feet to the large granite boulder," but the boulder is 412 feet away. Where does the line end, and why?

Show answer

At the boulder. Monuments generally control over courses and distances, because the parties could see the monument and presumably intended it as the boundary.

9. **Hard** A strip of land is 2 chains wide and 1 mile long. How many acres is it?

Show answer

1 mile is 80 chains, so the strip is 2 × 80 = 160 square chains; at 10 square chains per acre, that is 16 acres. (Check in feet: $132 \times 5{,}280 = 696{,}960$ sq ft ÷ 43,560 = 16 acres.)

10. Hard What is a benchmark, and what is it measured from?

Show answer

A benchmark is a permanent reference marker, usually a metal disk in rock or concrete, whose elevation has been precisely measured. Its elevation is measured from a datum, a reference surface such as mean sea level.

11. Challenge Washington's plat shows a line of 320 poles and another of 220 poles. Convert both to feet and to chains.

Show answer

320 poles × 16.5 = 5,280 feet = 80 chains (one mile). 220 poles × 16.5 = 3,630 feet = 55 chains.

12. Challenge In three sentences, explain to a new buyer why her lender wants a survey even though she has title insurance.

Show answer

A title search and title insurance deal with the public records — who owns the land and what liens and recorded rights affect it. Many problems are physical, not recorded: a neighbor's fence over the line, a driveway that crosses the boundary, a house built too close to the edge. Only a survey measures the ground and reveals those encroachments before the buyer inherits them.

COMMON MISTAKES

- Ending a description at the last monument — a metes-and-bounds description must return to the point of beginning to close.
- Writing bearings that start with east or west or exceed 90 degrees — every bearing starts with N or S and turns 0° to 90° toward E or W.
- Confusing the rod (16½ feet) with the chain (66 feet) — four rods make one chain.
- Believing a title search reveals encroachments — only a survey of the ground does.
- Letting distances override monuments — monuments generally control over courses, and courses over distances.
- Calling a street address or a tax parcel number a legal description — neither tells a surveyor where the boundaries run.

Make it a game · Walk the Line. Set a point of beginning in the yard or a large room — a chair, a stone. The caller reads a short metes-and-bounds description using simple bearings and paces: "North 0° East 10 paces, thence South 90° East 6 paces, thence South 0° West 10 paces, thence…" The walker follows it with a compass app and must finish standing on the point of beginning. The family scores one point for a closed description, and the caller loses a point for any bearing that starts with East or West. Then switch roles and add a twist: one caller hides a monument ("to the red cup") and the walker must find it.

Scripture. "Thou shalt not remove thy neighbour's landmark, which they of old time have set in thine inheritance, which thou shalt inherit in the land that the LORD thy God giveth thee to possess it." (Deuteronomy 19:14, KJV)

A landmark is a monument: the stone or post that marks where one family's land ends and another's begins. Moving it in the night was theft that looked like nothing at all, which is why the law of Moses named it. Every metes-and-bounds description depends on monuments staying where honest people set them.

1.4 Sections and Townships: The Rectangular Survey and the Recorded Plat

OBJECTIVES

- Explain how the Land Ordinance of 1785 created the Public Land Survey System of principal meridians, base lines, ranges and townships.
- Locate a township by its township tier and range, and number the 36 sections of a township correctly.
- Compute the acreage of any aliquot part of a section and convert acres to square feet.
- Explain correction lines, guide meridians and government lots, and why they exist.
- Read a lot-and-block description from a recorded plat and name the meridians that govern the Pacific Northwest states.

> **Warm-up.** Draw a square and divide it into a 6-by-6 grid of 36 small squares. Number the squares 1 to 36 in any order you think would be easiest for a surveyor walking the land. Keep your drawing — in this lesson you will see the order Congress's surveyors actually used, and why.

WATCH

Understanding the Public Land Survey System

Mike Pesses · 19:08

https://www.youtube.com/watch?v=3HfsgcI-r10

> **WHEN TO WATCH**
> Watch after the big idea with graph paper in hand; draw the meridian, base line and township grid along with him, and stop when he locates his sample township to find it on your own drawing first.

BACKUP VIDEO

N 1/2 of SW 1/4 AND SW 1/4 of NE 1/4 Has How Many Acres? | Real Estate Exam Prep

The Real Estate Classroom · 4:13

https://www.youtube.com/watch?v=jx6ZrE0JZwk

Watch before the practice set; pause after the instructor reads the description and compute the acreage yourself before he does.

KEY TERMS

rectangular survey system

The method of legal description, also called the government survey system or Public Land Survey System, that divides land into townships and sections measured from principal meridians and base lines.

principal meridian

A north–south survey line established as the reference for all townships and ranges in a survey area.

base line

An east–west survey line that crosses a principal meridian at an initial point and serves as the reference for township tiers north and south.

range

A north–south column of townships, six miles wide, numbered east or west of a principal meridian.

township tier

An east–west row of townships, six miles high, numbered north or south of a base line; also called a township line or tier.

township

A square of land six miles on each side (36 square miles), divided into 36 sections.

section

One square mile of land — 640 acres — the basic unit within a township, numbered 1 to 36.

correction line

A standard parallel run every 24 miles north and south of the base line to correct for the narrowing of townships caused by the curvature of the earth; guide meridians are run every 24 miles east and west.

government lot

An irregular fractional parcel, numbered as a lot, created where a section cannot be a full square because of a body of water, a state line or the corrections of the survey.

lot and block

A method of legal description that identifies land by its lot and block numbers on a subdivision plat recorded in the county records; also called the recorded plat system.

aliquot part

A regular fractional division of a section, such as a half or a quarter of a quarter, used in rectangular survey descriptions.

CORE IDEAS

The story. In 1850 Congress created the office of Surveyor General of Oregon and passed the Donation Land Claim Act, which promised free land to settlers in the Oregon Territory — which then included what would become Washington. Thousands of families were already plowing claims along the Willamette, and none of the land had ever been surveyed. The new surveyor general, John B. Preston, arrived in 1851 to begin the work. He had to start somewhere, and he chose the spot carefully: a point in the forested hills west of Portland, placed so that the east–west base line would not have to cross the Columbia River and the north–south meridian would pass west of Vancouver Lake. On June 4, 1851, Preston drove a red cedar stake into the ground there. From that single point surveyors with solar compasses and 66-foot chains ran a line north toward Canada, south toward California, east toward Idaho and west to the Pacific. Every township in Oregon and Washington is still measured from that spot. In 1885 the stake was replaced by a stone obelisk, the **Willamette Stone**, which still stands in a small state heritage site above the city.

How they figured it out. Preston was carrying out a plan laid down sixty-six years earlier. After the Revolution, the new nation owned vast western lands and needed to sell them, but it could not survey them tract by tract in the old colonial way — metes and bounds had left Virginia and Kentucky tangled in overlapping claims and lawsuits. The **Land Ordinance of 1785**, adopted by Congress on May 20, 1785, ordered the western lands surveyed before sale into a grid of square **townships** six miles on a side, each divided into thirty-six one-mile-square lots, later called **sections**, with one lot in each township reserved for public schools. Surveying began that same year in the Seven Ranges of eastern Ohio, at the point where the Pennsylvania border meets the Ohio River. The grid worked: land could be described, sold and recorded by a few numbers, without walking its edges. As the nation grew, surveyors established new principal meridians and base lines for each region, and the **Public Land Survey System**, administered today by the Bureau of Land Management, now covers about thirty states — every state west of the

original colonies except Kentucky, Tennessee, Texas and a few others settled under older systems.

The big idea. The **rectangular survey system** describes land by its position in a grid. Each survey area has a **principal meridian** running north–south and a **base line** running east–west, crossing at an **initial point** such as the Willamette Stone. Lines six miles apart are run parallel to both. The columns between north–south lines are **ranges**, numbered east or west of the meridian (Range 2 East, or R2E). The rows between east–west lines are **township tiers**, numbered north or south of the base line (Township 3 North, or T3N). Where a tier and a range cross is a single **township**: a square 6 miles by 6 miles, containing 36 square miles. "T3N, R2E, Willamette Meridian" identifies exactly one township in the country. Each township is divided into 36 **sections**, each 1 mile square and containing **640 acres**. The sections are numbered in a back-and-forth pattern, as an ox plows a field: section 1 in the northeast corner, running west to section 6 in the northwest corner, dropping down to section 7 and running east to 12, and so on, so that section 36 lies in the southeast corner. Sections 1 and 36 both lie on the east edge of the township; sections 6 and 31 mark the corners of the west edge.

Smaller parcels are described as **aliquot parts** of a section — halves and quarters, and quarters of quarters. A quarter section contains 160 acres; a quarter of a quarter, 40 acres; a quarter of a quarter of a quarter, 10 acres. To find the acreage of a description, read it as written and multiply 640 by every fraction: "the NE¼ of the SW¼ of Section 14" is $640 \times \frac{1}{4} \times \frac{1}{4} = 40$ acres. To *locate* the parcel, read it backward, from the largest unit to the smallest: find Section 14, then its southwest quarter, then the northeast quarter of that. Watch the word "and" or a semicolon: "the N½ of the SW¼ *and* the SE¼ of Section 10" describes two separate parcels whose acreages are added — 80 + 160 = 240 acres. Distances follow from the grid: a section is 5,280 feet on a side, a quarter section 2,640 feet, and a quarter-quarter 1,320 feet. Because an acre is 43,560 square feet, a 40-acre quarter-quarter contains $40 \times 43{,}560 = 1{,}742{,}400$ square feet — exactly $1{,}320 \times 1{,}320$.

The earth is round, and the grid is square, so the system builds in corrections. Meridians converge as they run north, so townships would grow narrower and narrower. To correct for this, surveyors run **standard parallels**, also called **correction lines**, every 24 miles north and south of the base line, and **guide meridians** every 24 miles east and west of the principal meridian, starting the

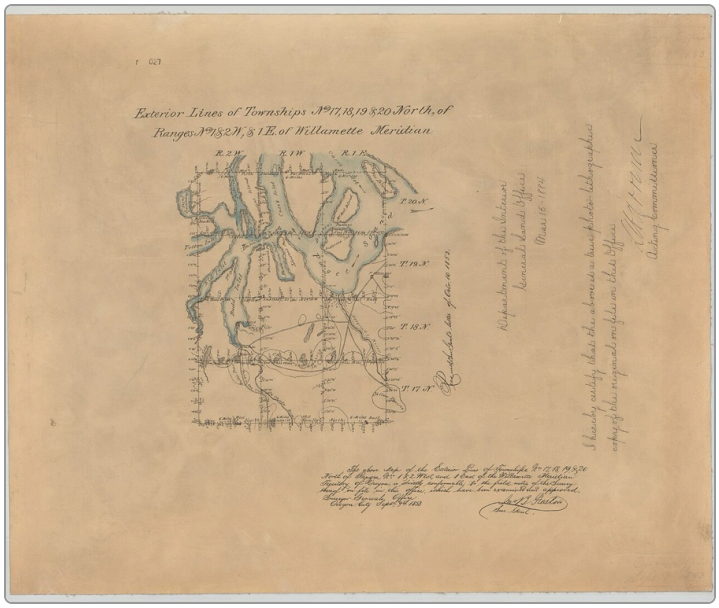
measurements fresh at each one. The 24-mile squares they form are sometimes called checks or quadrangles, each containing 16 townships. Within each township, the surveyors pushed the accumulated errors to the north and west edges, so sections along the north and west sides of a township may not be exactly 640 acres. Irregular pieces that cannot be full aliquot parts — along those edges, along rivers and lakes, at state lines — are numbered as **government lots** ("Government Lot 3 of Section 6"). The Pacific Northwest is measured from several initial points: the **Willamette Meridian** governs both Oregon and Washington; Idaho uses the **Boise Meridian**; Montana uses the **Principal Meridian Montana**; and Alaska, too vast for one grid, uses five — the Copper River, Fairbanks, Kateel River, Seward and Umiat meridians.

The third method of legal description grows out of the first two. When a developer divides a tract into building lots, a surveyor prepares a **subdivision plat** — a detailed map showing each lot's dimensions, the blocks, streets, easements and the subdivision's boundary, itself tied by metes and bounds or by the rectangular survey to a known point. Once the county approves and records the plat, each lot can be described simply by reference to it: "Lot 7, Block 3, Riverbend Addition, as recorded in Volume 12 of Plats, page 45, records of the county." This is the **lot-and-block**, or **recorded plat**, method, and it describes most suburban and city homes in America. Note what is *not* a legal description: the street address, and the county assessor's **parcel number**, which is a tax-roll identifier. The assessor's tax map is useful for finding a parcel, but deeds rely on the recorded description. Some descriptions combine methods — "the north 200 feet of the SE¼ of the NE¼ of Section 22" uses the rectangular survey and a measured distance together.

On the exam today. This lesson produces some of the most reliable points on the exam, so master the arithmetic. Know the numbers cold: a township is 6 miles square, 36 square miles, 36 sections; a section is 1 square mile, 640 acres, 5,280 feet on a side; an acre is 43,560 square feet. Know the numbering: section 1 in the northeast corner, 6 in the northwest, 36 in the southeast, with the numbers snaking back and forth. Expect at least one acreage question — multiply 640 by every fraction, and add when you see "and." Traps: "a township is 6 square miles" (no — 6 miles square, which is 36 square miles); "ranges run east–west" (ranges are columns counted east or west, but the lines bounding them run north–south); "section 36 is in the northwest corner" (southeast); and "a tax parcel number is a legal description"

(it is not). If a question asks which method uses meridians and base lines, the answer is the rectangular survey; if it mentions a recorded map of a subdivision, it is lot and block.

PICTURE STUDY



Exterior Lines of Townships 17, 18, 19 and 20 North, Ranges 1 and 2 West and 1 East, Willamette Meridian (Olympia, Washington), Surveyor General's Office, Oregon City, under John B. Preston, September 9, 1853 · Ink and watercolor survey plat (photolithographic copy certified by the General Land Office, 1874) · Bureau of Land Management survey records, Oregon/Washington State Office

Image: Wikimedia Commons, public domain

This is one of the earliest survey plats of what is now Washington, approved at the Surveyor General's Office in Oregon City on September 9, 1853, and signed by John B. Preston — the man who drove the stake at the Willamette Stone two years before. It shows the exterior lines of four tiers of townships around the inlets of southern Puget Sound, where Olympia stands today. It opens this lesson because you can watch the great grid meet real geography: straight lines marching across water and islands, each township numbered from a cedar stake more than a hundred miles south.

Look closely

- Find the range labels across the top (R.2W, R.1W, R.1E) and the township labels down the right edge (T.17N to T.20N). Put your finger on T18N, R2W — the township Olympia occupies.
- Notice that the plat shows only the exterior lines of the townships. The sections inside were surveyed later. Why would surveyors run the six-mile lines first?

- Look at the inlets cutting through the squares. Sections that touch the shore cannot be full 640-acre squares — what would they be numbered as?
- Read the signature at the bottom right and the certification running down the side, dated 1874 at the General Land Office. A plat is a public record, certified so anyone can rely on it.

Talk about it

1. If a settler's claim lay in the township just east of the one labeled T18N, R2W, what would its township and range be?
2. Why did a straight-line grid make it easier for the government to sell land to thousands of settlers than the metes-and-bounds system Washington used in Virginia?
3. Preston and his crews carried chains through forest and across water so that families they would never meet could hold clear title to their land. What does that kind of careful, unseen work for strangers teach about doing a job well?

PROJECT

Find Your Place on the Grid

Every piece of land in the public-land states has an address on the national grid. In this project you will find yours: the meridian, township, range and section of your own home or church, and then the lot-and-block description from the recorded plat if you live in a subdivision. If your state is not a public-land state, use a parcel in a Northwest county instead and note which system your own state uses.

You will need

- Graph paper, ruler and colored pencils
- Your county assessor's online parcel map (free and public)
- The Bureau of Land Management's General Land Office Records website (free)
- Your exam notebook

Steps

1. Draw a large township grid and number all 36 sections correctly, starting with 1 in the northeast corner and snaking back and forth to 36 in the southeast.
2. Using the assessor's parcel map or GLO Records, find the meridian, township, range and section of your chosen parcel. Write it in standard form, for example: "Section 14, T2N, R3E, Willamette Meridian."
3. Shade your section on your grid. Divide it into quarters and quarter-quarters, label each with its aliquot description and acreage (NE¼ = 160 acres; NE¼ of NE¼ = 40 acres, and so on).
4. Mark the approximate location of your parcel in its quarter-quarter and estimate its acreage from the assessor's record; convert that to square feet.
5. If the parcel is in a subdivision, find its lot, block and plat name in the assessor's record (no owner names needed) and write the lot-and-block description in full form.

6. On GLO Records, look for the original survey plat of your township and note the year it was approved and the surveyor general who signed it, if shown.
7. Write a short paragraph comparing the three ways your parcel could be described, and title the page “My Place on the Grid,” dated, for your Pathway File.

EXAM NOTEBOOK

1. Flashcards for every key term, plus a numbers card: township 6 × 6 miles = 36 sq mi = 36 sections; section 1 sq mi = 640 acres = 5,280 ft on a side; quarter 160; quarter-quarter 40; acre 43,560 sq ft.
2. Draw a numbered township from memory every day this week until you can do it in under one minute, then draw one section divided into quarters and quarter-quarters with acreages written in each.
3. Write a trap list titled “The Grid”: 6 miles square, not 6 square miles; section 1 northeast, 36 southeast; read backward to locate, multiply to compute; add on “and”; a tax parcel number is not a legal description.

KEY FORMULAS

$$1 \text{ township} = 6 \text{ mi} \times 6 \text{ mi} = 36 \text{ sq mi} = 36 \text{ sections}$$

$$1 \text{ section} = 1 \text{ sq mi} = 640 \text{ acres}$$

$$\text{acres in an aliquot part} = 640 \times \text{each fraction in the description}$$

$$\text{square feet} = \text{acres} \times 43{,}560$$

From history. The Land Ordinance of 1785 reserved lot number 16 in every township “for the maintenance of public schools.” As new states entered the Union, Congress granted them school sections — first section 16, later sections 16 and 36 in many western states, including Oregon and Washington, and even more in some later states. Many of those school-trust lands are still owned by the states today, managed as timber, grazing and farm land whose income supports public schools.

Example 1. Exam style. How many acres are in the S½ of the NW¼ of the SE¼ of Section 22?

A. 10 acres

B. 20 acres

C. 40 acres

D. 80 acres

Show solution

1. Write the fractions as they appear: ½, ¼, ¼.
2. Multiply 640 by each: $640 \times \frac{1}{2} \times \frac{1}{4} \times \frac{1}{4} = 20$.
3. To locate it, read backward: Section 22 → its SE quarter (160 acres) → that quarter's NW quarter (40 acres) → the south half of that (20 acres).

Answer: B. 20 acres.

Example 2. A farm is described as "the N½ of the NE¼ and the SE¼ of the NE¼ of Section 9." How many acres is it, and how many square feet?

Show solution

1. The word "and" separates two parcels; compute each and add.
2. First parcel: $640 \times \frac{1}{2} \times \frac{1}{4} = 80$ acres.
3. Second parcel: $640 \times \frac{1}{4} \times \frac{1}{4} = 40$ acres.
4. Total: $80 + 40 = 120$ acres; in square feet, $120 \times 43{,}560 = 5{,}227{,}200$.

Answer: 120 acres, or 5,227,200 square feet — three-quarters of the northeast quarter of Section 9.

Example 3. In a standard township, which section lies directly south of Section 1, and which section lies directly east of Section 18?

Show solution

1. Draw the grid. Top row, right to left: 1, 2, 3, 4, 5, 6. Second row, left to right: 7, 8, 9, 10, 11, 12. Third row, right to left: 13 to 18.
2. Section 1 is in the northeast corner; directly below it is the rightmost section of the second row, which is 12.
3. Section 18 is the leftmost section of the third row (because the third row runs right to left, 13 at the east end and 18 at the west end).
4. Directly east of 18 is 17.

Answer: Section 12 lies south of Section 1; Section 17 lies east of Section 18.

PRACTICE

1. Easy How many sections are in a township, and how many acres are in a section?

   Show answer

   36 sections in a township; 640 acres in a section.

2. Easy In which corner of a township is Section 1, and in which corner is Section 36?

   Show answer

   Section 1 is in the northeast corner; Section 36 is in the southeast corner.

3. Easy Which principal meridian governs land surveys in both Washington and Oregon?

   Show answer

   The Willamette Meridian, measured from the Willamette Stone near Portland.

4. Medium How many acres are in the NW¼ of the SE¼ of Section 30?

   Show answer

   $640 \times \frac{1}{4} \times \frac{1}{4} = 40$ acres.

5. Medium What is the difference between a range and a township tier?

Show answer

A range is a north–south column of townships counted east or west of the principal meridian; a township tier is an east–west row counted north or south of the base line.

6. Medium A buyer's parcel is described as "Lot 12, Block 4, Hillcrest Addition, as recorded in Book 7 of Plats, page 18." Which method of legal description is this, and where would you find the map?

Show answer

Lot and block (the recorded plat system). The plat map is recorded with the county recorder (or auditor) in the plat book and page cited.

7. Medium Why are correction lines needed?

Show answer

Meridians converge as they run toward the North Pole, so townships would grow narrower. Correction lines (standard parallels) every 24 miles, with guide meridians every 24 miles, reset the measurements so townships stay close to six miles wide.

8. Hard How many acres are in "the E½ of the NE¼ and the NW¼ of the SE¼ of Section 5"?

Show answer

First parcel: $640 \times \frac{1}{2} \times \frac{1}{4} = 80$ acres. Second: $640 \times \frac{1}{4} \times \frac{1}{4} = 40$ acres. Total 120 acres.

9. Hard A quarter-quarter section sells for $6,000 an acre in this example. What is the price?

Show answer

A quarter-quarter is 40 acres: $40 \times \$6{,}000 = \$240{,}000$.

10. Hard A parcel at the edge of a lake is described as "Government Lot 2, Section 18." Why isn't it described as an aliquot part?

Show answer

The lake keeps that part of the section from being a regular square or fraction, so the surveyors numbered the irregular land as a government lot. Government lots also occur along the north and west edges of townships, where survey corrections accumulate, and at state lines.

11. Challenge How many square feet are in the SW¼ of the SW¼ of the SW¼ of a section, and what is the length of one side in feet?

Show answer

$640 \times \frac{1}{4} \times \frac{1}{4} \times \frac{1}{4} = 10$ acres; $10 \times 43{,}560 = 435{,}600$ sq ft. As a square, each side is 660 feet (a section side of $5{,}280 \div 8$).

12. Challenge Explain in three sentences why the Land Ordinance of 1785 ordered land to be surveyed before it was sold, using what you learned about metes and bounds in Virginia and Kentucky.

Show answer

In the colonial system, settlers claimed land first and described it afterward by metes and bounds, so claims overlapped and courts were filled with boundary disputes. Surveying a grid before sale meant every parcel had a unique, pre-measured description that could not overlap any other. A buyer could know exactly what he bought from a few numbers, and the government could sell land quickly and record it clearly.

COMMON MISTAKES

- Saying a township is 6 square miles — it is 6 miles square, which is 36 square miles.
- Numbering sections like reading a book, left to right on every row — they snake back and forth, beginning with 1 in the northeast corner and ending with 36 in the southeast.
- Locating a parcel by reading the description front to back — compute acreage by multiplying all fractions, but locate it by reading backward from the section.
- Forgetting to add parcels joined by "and" or a semicolon — they are separate tracts whose acreages are summed.

- Confusing ranges with tiers — ranges are columns east or west of the meridian; tiers are rows north or south of the base line.
- Treating an assessor's parcel number or a street address as a legal description — deeds rely on metes and bounds, the rectangular survey or a recorded plat.

Make it a game · Section Sprint. Each player gets a blank 6-by-6 grid. The caller rolls two dice and calls a section number (add them, or multiply for bigger numbers, up to 36); players race to write the number in the right square. First correct earns a point. Round two: the caller reads an aliquot description — "the S½ of the NE¼" — and players race to shade it on a section square and shout the acreage. Round three is the speed round: the caller says "40 acres" and players must call out a description that fits. Highest score after three rounds names the next township.

Scripture. "The lines are fallen unto me in pleasant places; yea, I have a goodly heritage." (Psalm 16:6, KJV)

David speaks of his portion in the language of surveyed land: the measuring lines that marked out each family's inheritance in Israel. The rectangular survey drew such lines for millions of American families who had never owned land before. Every line on the grid is a reminder that a place to live and work is a gift to be received with gratitude.

1.5 Above, Below and Beside: Air, Mineral and Water Rights

OBJECTIVES

- Describe the three dimensions of land ownership — surface, subsurface and air rights — and explain how each can be severed and sold separately.
- Explain mineral rights and mineral leases, including the split estate, royalties and the right of capture for oil and gas.
- Distinguish riparian, littoral and prior-appropriation water rights and state which doctrine governs the western states.
- Define accretion, alluvion, reliction, erosion and avulsion, and state how each affects ownership.
- Explain transferable development rights and lateral and subjacent support.

> **Warm-up.** Imagine you own a one-acre lot beside a river. In five minutes, list everything you think you own: the soil, the water flowing past, the fish, the gravel under the riverbed, the oil a mile down, the air where a plane flies over. Mark each item “mine,” “not mine” or “not sure.” You will settle every “not sure” by the end of this lesson.

WATCH

Surface, Air, Water & Mineral Rights in Real Estate

Dee Kumar Real Estate · 4:18

https://www.youtube.com/watch?v=GeB8LxKjz1I

> **WHEN TO WATCH**
> Watch after the big idea; draw a cross-section of a parcel (air, surface, subsurface) and label each kind of right on it as the video names it.

BACKUP VIDEO

The Prior Appropriation System

Water in the Western US · 16:36

https://www.youtube.com/watch?v=tJWkoq2KCSA

Watch after the worked examples for a deeper look at how senior and junior rights are called in a dry year; sketch the river diagram she draws and mark which users are shut off first.

KEY TERMS

air rights

The rights to use the space above the surface of land, which can be sold, leased or transferred separately from the surface.

mineral lease

A contract giving a company the right to explore for and remove minerals, oil or gas, usually in exchange for a royalty on what is produced.

littoral rights

The rights of an owner whose land borders a large, non-flowing body of water, such as a lake, sea or ocean, to use and enjoy the water and shore.

accretion

The gradual increase of land by the deposit of soil or sand along a shoreline or riverbank; the added land belongs to the owner of the shore.

reliction

The gradual increase of land when water permanently recedes and exposes land that was underwater; also called dereliction.

subsurface rights

The rights to the area below the surface, including minerals, oil and gas; also called mineral rights when they concern minerals, and severable from surface rights.

riparian rights

The rights of an owner whose land borders a flowing body of water, such as a river or stream, to reasonable use of the water.

prior appropriation

The doctrine, used in most western states, that water rights belong to whoever first puts the water to beneficial use and secures a right under state law — "first in time, first in right" — regardless of who owns the bank.

alluvion

The soil or sand deposited by water through accretion; also called alluvium.

erosion

The gradual wearing away of land by water, wind or ice, which reduces the owner's land.

avulsion

The sudden loss or removal of land by a natural force such as a flood or a river suddenly changing its course; the boundary generally does not move.

transferable development rights

Unused rights to build on one parcel — often unused air rights — that local law allows to be sold and used on another parcel.

CORE IDEAS

The story. In 1863 a group of farmers in the Colorado Territory dug a ditch to carry water from the south fork of the St. Vrain River across a divide into the valley of Left Hand Creek, where their dry fields lay. They had no land along the St. Vrain at all; they simply took the water first and put it to work growing crops. Sixteen years later, in the dry season of 1879, there was not enough water in the stream for everyone. Downstream farmers whose land bordered the St. Vrain — men who had always assumed that owning the riverbank meant owning a right to the river — went up to the Left Hand Ditch Company's dam and tore part of it out to let the water flow down to them. The company sued, and in 1882 the Supreme Court of Colorado decided *Coffin v. Left Hand Ditch Co.* The court held that in Colorado the right to water does not come from owning land beside it. It comes from being first to divert the water and put it to a beneficial use. The ditch company had been first. The downstream landowners lost.

How they figured it out. In England and the rainy eastern states, water law grew up around rivers and mills, and it gave rights to whoever owned the bank. That made sense where water was plentiful. In the arid West it did not. The miners of the California gold fields in the 1850s had already settled water disputes by their own rule: whoever first diverted a stream and used the water had the better right, and later comers could take only what was left. Western courts and legislatures turned the miners' custom into law. Colorado wrote it into its constitution, and the *Coffin* case declared it the exclusive rule there; other western states followed, building permit systems run by state agencies. Oregon's Water Code of 1909 is a clear example: it declared that all water within the state belongs to the public and that, subject to rights already existing, water may be appropriated for beneficial use only under a permit from the state, with the date of the application usually becoming the right's priority date. Today Washington, Oregon, Idaho, Montana and Alaska all allocate water by prior appropriation through state permits, while many eastern states still follow the riparian rule.

The big idea. Ownership of land extends in three directions, and each can be separated from the others. **Surface rights** cover the land itself and what is built on it. **Subsurface rights** run below the surface — soil, rock, minerals, oil and gas. **Air rights** run above the surface into the airspace. In old common law an owner held everything "up to the heavens and down to the center of the earth," and the national exam still describes land that way. But the bundle can be split. An owner may sell the minerals and keep the surface, sell the surface and keep the minerals, or sell the right to build in the air above a building. When the surface belongs to one owner and the minerals to another, the land is called a **split estate** — common in the West, where the federal government kept the minerals under millions of acres it granted to homesteaders. The modern limit on air rights is practical: in *United States v. Causby* (1946), the Supreme Court held that the ancient "to the heavens" rule had no place in a world of aircraft, though an owner still controls the airspace he can reasonably use and enjoy.

Air rights matter most where land is scarce and expensive. When Grand Central Terminal in New York opened in 1913, its railroad had put its tracks underground and sold and leased the right to build above them; office towers and apartment buildings rose along Park Avenue on platforms over the trains. Condominium units are described partly as air lots — cubes of airspace at stated elevations above a datum. Cities sometimes allow **transferable development rights** (TDRs): the owner of a historic building or protected farmland who cannot use the full building height or density allowed by zoning may sell that unused right to an owner elsewhere, who may then build higher or denser. **Mineral rights** are commonly developed through a **mineral lease**, by which an oil, gas or mining company receives the right to explore and extract in exchange for an up-front payment and a **royalty** — a share, such as one-eighth in this example, of what is produced. Because oil and gas move underground, many states apply a **rule of capture**: oil and gas belong to whoever brings them to the surface from a well on his own land, subject to state conservation rules. Every owner also has a right of **support**: *lateral* support from neighboring land beside it and *subjacent* support from the strata beneath it, so that excavation or mining does not make the surface collapse.

Water rights come in three doctrines the exam names. **Riparian rights** belong to owners of land bordering a flowing body of water — a river or stream. Each riparian owner may make reasonable use of the water but may not unreasonably diminish its

flow or quality for others downstream. Where the river is *navigable*, the riparian owner generally owns the land to the water's edge and the state owns the bed; where it is *non-navigable*, the owner generally owns to the center of the stream, called the thread. **Littoral rights** belong to owners of land bordering large, non-flowing bodies of water — lakes, seas and the ocean — and generally run to the average high-water mark, with the state holding the land beyond. **Prior appropriation**, the western doctrine, does not depend on owning the bank at all. Its rules are simple to state: first in time, first in right; the water must be put to a **beneficial use**, such as irrigation, domestic supply, industry or stock watering; the right is obtained through the state, usually by permit; and a right that is not used may be lost ("use it or lose it"). In a dry year, the senior right is filled first and the junior rights are cut off, no matter how close the junior user lives to the river.

Water also moves land. **Accretion** is the slow addition of land as a river or sea deposits soil or sand along the shore; the deposited material itself is called **alluvion** (or alluvium), and the new land belongs to the owner of the shore it attaches to. **Reliction**, also called dereliction, adds land when water permanently recedes — a lake slowly shrinking leaves new dry land, which also belongs to the shoreline owner. **Erosion** is the slow wearing away of land by water, wind or ice, and the owner simply loses what washes away. **Avulsion** is sudden: a flood tears away a field, or a river jumps its banks overnight and cuts a new channel. Because avulsion is sudden and the old boundary can still be identified, the boundary generally stays where it was, and an owner may reclaim land that is identifiable. Learn the pattern: gradual changes (accretion, reliction, erosion) move the boundary with the water; sudden changes (avulsion) do not. A licensee should never promise a buyer a water right or a shoreline boundary; those are questions for the state water agency, a surveyor and an attorney.

On the exam today. Expect two or three questions. The classic pair is riparian versus littoral: riparian is flowing water — rivers and streams; littoral is still or tidal water — lakes, seas and oceans. A memory hook: ri-parian for rivers, littoral for lakes and the ocean's lit-toral shore. The second is prior appropriation: first in time, first in right; beneficial use; state permit; not tied to owning the bank. The third is the vocabulary of moving land: accretion adds gradually (alluvion is the soil deposited), reliction adds when water recedes, erosion takes gradually, avulsion takes suddenly. Traps to watch: "alluvion is the process" (it is the deposited soil; accretion is the process);

“avulsion moves the boundary” (generally not); “riparian rights apply to an ocean beach” (littoral); and “mineral rights cannot be sold separately from the surface” (they can — that creates a split estate). Air rights can be sold or leased separately too, and unused rights may be transferred as TDRs.

PICTURE STUDY



The Willamette Falls, Oregon, Carleton E. Watkins, 1867 · Albumen stereograph · New York Public Library, Robert N. Dennis Collection of Stereoscopic Views

Image: Wikimedia Commons, public domain

Carleton E. Watkins (1829–1916) was the great photographer of the early American West, famous for his mammoth-plate views of Yosemite. In 1867 he carried his heavy camera to Oregon and photographed the Willamette Falls at Oregon City, where the river drops over a basalt ledge. The falls powered some of the first mills in the Pacific Northwest, and the town on the far bank grew because of the water. This stereograph — two images meant to be seen through a viewer as one three-dimensional scene — opens this lesson because it shows a river as the old law saw it: a source of power and wealth for those who owned its banks and those who could put its water to use.

Look closely

- Look across the river at the town. Its buildings line the bank — a reminder of why owning the water's edge once seemed to settle every question about the water.
- Study the rocks in the foreground. Who owns the bed of a navigable river like the Willamette — the owner of the bank or the state?
- Notice the long curve of the falls. The water that pours over them was diverted for mills and later for power; in Oregon after 1909, every new use needed a state permit.

- Compare the two images on the card. They look the same, but the viewpoints differ by a few inches — enough to create depth when seen through a stereoscope.

Talk about it

1. If a mill owner on the far bank and a farmer miles from the river both wanted this water in a dry year, how would the riparian rule and prior appropriation answer differently?
2. Over many years the river may build up a gravel bar against one owner's bank. What is the process called, and who owns the new land?
3. Water is shared by everyone downstream. What does it mean to use a shared gift like a river honestly and generously, and where does Scripture show neighbors quarreling — and making peace — over wells?

PROJECT

The Three-Dimensional Parcel

In this project you will build a cross-section diagram of a pretend riverfront parcel showing every right in three dimensions, and then a one-page water-rights brief for your own state from its official water agency. Licensees are not water lawyers, but a licensee who knows which questions to ask — and which agency answers them — protects every rural buyer.

You will need

- A large sheet of paper or poster board, ruler and colored pencils
- Your state water agency's website (in the Northwest: Washington Department of Ecology, Oregon Water Resources Department, Idaho Department of Water Resources, Montana Department of Natural Resources and Conservation, Alaska Department of Natural Resources)
- Your exam notebook

Steps

1. Draw a side-view cross-section of a pretend 20-acre farm beside a river: airspace above, house and barn on the surface, soil and rock below, an oil-bearing layer deep underground, and the river at one edge.
2. Label surface rights, air rights, subsurface (mineral) rights, lateral and subjacent support, and the riparian edge. Add a note for whether you have drawn a navigable or non-navigable river and where the owner's boundary would generally run.
3. Show a split estate: write "Minerals reserved to the United States, 1912" (a pretend reservation) on the oil layer and explain in one sentence what that means for a buyer.
4. Draw four small before-and-after sketches along the river: accretion, reliction, erosion and avulsion, each with one sentence on who owns the land afterward.
5. On your state water agency's website, find how a new water right is obtained (permit, application, priority date) and whether any uses are exempt. Write a five-sentence brief in your own words, dated, citing the agency by name.

6. List three questions a buyer of rural land should ask about water before signing a purchase agreement.
7. Title the poster and brief "The Three-Dimensional Parcel" and add them to your Pathway File.

EXAM NOTEBOOK

1. Flashcards for every key term; put riparian and littoral on the same card with a sketch of a river on one side and a lake on the other.
2. Draw a timeline arrow labeled GRADUAL → (accretion adds, reliction adds, erosion takes; boundary moves) and a lightning bolt labeled SUDDEN → (avulsion; boundary generally stays).
3. Write a trap list titled "Water and Air": riparian = rivers, littoral = lakes and oceans; prior appropriation = first in time, beneficial use, state permit; alluvion is the soil, accretion is the process; minerals and air can be sold separately.

> **From history.** The phrase the exam uses for the old extent of land ownership comes from a medieval Latin maxim: *cujus est solum, ejus est usque ad coelum et ad inferos* — "whoever owns the soil owns it up to the heavens and down to the depths." English lawyers quoted it for centuries. In 1946 the U.S. Supreme Court, deciding a case about military planes flying so low over a North Carolina chicken farm that the chickens died of fright, finally declared that the maxim "has no place in the modern world" — though landowners still own the airspace they can reasonably use.

Example 1. Exam style. Over twenty years a river slowly deposits sand along Ana's bank, adding half an acre to her farm. The added land is BEST described as:

A. Avulsion, and it belongs to the state

B. Reliction, and it belongs to the upstream owner

C. Alluvion added by accretion, and it belongs to Ana

D. Erosion, and it belongs to Ana's neighbor across the river

Show solution

1. The change is gradual — years of deposits — so it is accretion, not avulsion.
2. The deposited soil itself is alluvion (alluvium).
3. Land added by accretion belongs to the owner of the shore it attaches to — Ana.
4. B is wrong because reliction is land exposed by receding water, not deposited sand; D describes the opposite process, a loss of land.

Answer: C. Alluvion added by accretion belongs to the riparian owner, Ana.

Example 2. In a dry year, a western river carries enough water for only 100 units of use. Rancher Ortiz holds a 1902 water right for 70 units; Farmer Bell, whose land borders the river, holds a 1955 right for 50 units; Grower Chan, three miles from the river, holds an 1890 right for 40 units. Under prior appropriation, who gets water?

Show solution

1. Rank the rights by priority date, oldest first: Chan (1890), Ortiz (1902), Bell (1955).
2. Fill Chan's senior right first: 40 units, leaving 60.
3. Ortiz is next: his right is 70, but only 60 remain, so he receives 60.
4. Bell, the junior right, receives nothing — even though his land borders the river, because prior appropriation does not depend on owning the bank.

Answer: Chan receives 40 units, Ortiz 60 and Bell none: first in time, first in right.

Example 3. A downtown church owns a two-story historic building on a lot zoned for twelve stories. A developer across the street wants to build higher than his own zoning allows. How might the city's rules allow both owners to benefit, and what is the right being sold?

Show solution

1. The church is using only two of the twelve stories its zoning allows, leaving unused development capacity in the airspace above it.
2. If the city has a transferable development rights program, the church may sell some of that unused capacity.
3. The developer buys the TDRs and, under the program's rules, may add that capacity to his own building.
4. The church receives money to maintain its historic building, and the airspace above it stays open, usually guaranteed by a recorded restriction.

Answer: The church sells transferable development rights — unused air rights — which the developer uses to build higher, where local law allows.

PRACTICE

1. Easy What is the difference between riparian and littoral rights?

   Show answer

   Riparian rights belong to owners of land bordering flowing water such as rivers and streams; littoral rights belong to owners of land bordering large still or tidal water such as lakes, seas and oceans.

2. Easy State the rule of prior appropriation in five words.

   Show answer

   First in time, first in right — subject to beneficial use and a right obtained through the state.

3. Easy What is the difference between accretion and alluvion?

   Show answer

   Accretion is the process of gradual buildup of land by deposits; alluvion (alluvium) is the soil or sand actually deposited.

4. Medium A flood suddenly cuts a new river channel through Tom's farm, leaving ten acres on the far side of the river. Does the boundary move with the river?

Show answer

Generally no. A sudden change is avulsion, and the boundary stays where it was, so Tom still owns the identifiable ten acres on the far side.

5. Medium A rancher sells her land but keeps the oil and gas rights. What is this situation called, and what does the buyer receive?

Show answer

A split estate (a severance of subsurface rights). The buyer receives the surface rights; the rancher keeps the mineral rights, which she may later lease or sell.

6. Medium Which water doctrine do Washington, Oregon, Idaho, Montana and Alaska use to allocate water rights?

Show answer

Prior appropriation, administered through permits from each state's water agency.

7. Medium A lake slowly shrinks over decades, leaving a strip of new dry land along a cabin lot. What is this called, and who owns the strip?

Show answer

Reliction (dereliction). The newly exposed land generally belongs to the owner of the adjoining shore, the cabin owner.

8. Hard Why does an owner of land along a non-navigable creek generally own more land than an owner along a navigable river?

Show answer

Along a non-navigable stream the riparian owner generally owns to the center (thread) of the stream; along a navigable river the owner generally owns only to the water's edge, and the state owns the bed.

9. Hard An oil company signs a mineral lease paying a one-eighth royalty, in this example. A well produces oil worth $400,000 in a year. What is the owner's royalty?

Show answer

$\frac{1}{8} \times \$400{,}000 = \$50{,}000$. The royalty is the owner's share of production under the lease.

10. Hard A contractor digs a deep basement right at the property line, and the neighbor's garden wall and soil slide into the hole. What right of the neighbor was violated?

Show answer

The right of lateral support — the right to have land held in place by the neighboring land beside it. (Subjacent support is support from beneath, as in mining.)

11. Challenge In *Coffin v. Left Hand Ditch Co.* (1882), why did owning land on the St. Vrain River not give the downstream farmers the better right?

Show answer

Colorado followed prior appropriation, under which the right to water comes from being first to divert it and put it to beneficial use, not from owning the bank. The ditch company had appropriated the water first, so its senior right prevailed even though it owned no land on the river.

12. Challenge Write three sentences advising a buyer of a rural parcel with a creek in a western state about water.

Show answer

Owning land along a creek does not by itself give you the right to use its water in a prior-appropriation state; the right comes from a state permit or an existing recorded right with a priority date. Ask the seller for documentation of any water right and check it with the state water agency, noting its priority date and its permitted use. A junior right may be cut off in a dry year, so the date of the right matters as much as the amount.

COMMON MISTAKES

- Confusing riparian and littoral — riparian is rivers and streams; littoral is lakes, seas and oceans.

- Calling alluvion the process — accretion is the process; alluvion is the soil deposited.
- Thinking avulsion moves the boundary — sudden changes generally leave the boundary where it was; gradual changes move it.
- Assuming owning the riverbank grants water rights everywhere — in prior-appropriation states, rights come from first beneficial use and a state permit.
- Believing mineral or air rights cannot be separated from the land — both can be sold or leased separately, creating a split estate or transferable development rights.
- Mixing up lateral and subjacent support — lateral is from the side; subjacent is from beneath.

Make it a game · Gradual or Sudden?. Make five cards: ACCRETION, RELICTION, EROSION, AVULSION and ALLUVION. The caller describes a scene — "a spring flood carves a new channel overnight," "a lake shrinks over thirty years," "sand piles up on a beach each winter," "a cliff slowly crumbles into the sea." Players race to grab the right card and shout GAINED, LOST or STAYS (for the boundary). Then switch to a water-rights round with three cards — RIPARIAN, LITTORAL, PRIOR APPROPRIATION — and scenes like "a cabin on a big lake" or "a ditch from a river to a farm two miles away." Most cards wins.

Scripture. "And the herdmen of Gerar did strive with Isaac's herdmen, saying, The water is ours: and he called the name of the well Esek; because they strove with him. And they digged another well, and strove for that also: and he called the name of it Sitnah. And he removed from thence, and digged another well; and for that they strove not: and he called the name of it Rehoboth; and he said, For now the LORD hath made room for us, and we shall be fruitful in the land." (Genesis 26:20–22, KJV)

Water disputes are older than any law in this lesson: Isaac's herdsmen dug wells and the men of Gerar claimed the water as theirs. Isaac moved on rather than fight, and named the third well "Rehoboth" — room. Water law exists so that neighbors can share a limited gift without strife; the patience Isaac showed is still the best beginning to any boundary or water question.

UNIT 1

Land and Its Description

Every real estate transaction begins with two questions: *what* is being sold, and *where* exactly is it? This unit answers both. You will start inside an Ohio woolen mill in 1853, where a court had to decide whether the machines belonged to the land, and learn the difference between **land**, **real estate** and **real property**, the five tests for a **fixture**, and the rules for **trade fixtures** and **emblements**. You will see why land behaves unlike any other thing people buy — immobile, indestructible, unique — through the night Secretary Seward bought Alaska for two cents an acre.

Then you will learn to describe land the way the law does. You will walk a boundary with the young surveyor George Washington and write a **metes-and-bounds** description that closes; stand with John B. Preston at the cedar stake that became the Willamette Stone and count **townships** and **sections** across the **rectangular survey**; and read a **lot-and-block** description from a recorded plat. You will finish below the ground and above it, with mineral and air rights, and beside the water, with the **riparian**, **littoral** and **prior appropriation** doctrines that decide who may use a river. This unit carries some of the most dependable points on the national exam — vocabulary and acreage arithmetic — so keep your calculator and your index cards close.

PREREQUISITES

- Can multiply and divide by fractions such as ¼ and ½ and convert between feet and miles
- Can compute the area of a rectangle and divide large numbers on a basic calculator
- Has read the course introduction and set up a bound exam notebook and an index-card deck
- Can read a simple map with north, south, east and west

MASTERY CHECKLIST

- ☐ I can distinguish land, real estate and real property, and tell real from personal property.
- ☐ I can apply the five MARIA fixture tests and state that a written agreement overrides the others.
- ☐ I can explain trade fixtures, accession and emblements, and how annexation and severance change property's character.
- ☐ I can name and classify the three physical and four economic characteristics of land and the five rights in the bundle.
- ☐ I can read and write a metes-and-bounds description that returns to its point of beginning, and convert chains, rods and feet.
- ☐ I can number a township's 36 sections and compute the acreage of any aliquot part of a section.
- ☐ I can explain lot-and-block descriptions, correction lines and government lots, and name the meridians of the Northwest states.
- ☐ I can distinguish riparian, littoral and prior-appropriation rights and define accretion, alluvion, reliction, erosion and avulsion.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Bureau of Land Management: Cadastral Survey**: Free, official. The federal agency that runs the Public Land Survey System explains how the rectangular survey works and why it still matters. Read it with Lesson 1.4 before you build your township grid. Ages 14 and up.
- **BLM General Land Office Records**: Free, official. A searchable archive of original survey plats, field notes and land patents for the public-land states, including the Northwest. Use it in Lesson 1.4's project to find the original survey of your own township. Ages 14 and up.
- **NOAA National Geodetic Survey**: Free, official. The agency that maintains the nation's benchmarks and datums; its data explorer shows survey marks near your home. Use it for the Lesson 1.3 extension. Ages 15 and up.
- **Oregon Water Resources Department: Water Rights**: Free, official. Oregon's water agency explains prior appropriation, permits and priority dates under the state's water code. Read it with Lesson 1.5 for the water-rights brief. Ages 15 and up.
- **Washington Department of Ecology: Water Rights**: Free, official. Washington's agency for water rights explains how rights are obtained, which uses are exempt and how seniority works. A second state's view for Lesson 1.5 — compare it with your own state's agency. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

1.1 Real Property and the Things Fixed to It — 3 sessions of 50 minutes

1.2 Why Land Is Different: The Characteristics of Real Property
3 sessions of 50 minutes

1.3 Metes and Bounds: Walking the Line — 3 sessions of 50 minutes

1.4 Sections and Townships: The Rectangular Survey and the Recorded Plat
3 sessions of 50 minutes

1.5 Above, Below and Beside: Air, Mineral and Water Rights — 3 sessions of 50 minutes

Unit 1 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions in the style of the national exam, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. A score of 70% (14 of 20) matches the common passing line, but aim higher. Figures marked “in this example” are examples. Choose the one BEST answer.

1. **5 pts**

   Land plus the permanent improvements people have attached to it is BEST described as:

   A. Personal property

   B. Real estate

   C. Land

   D. A chattel real

2. **5 pts**

   When the parties disagree about whether an item is a fixture, which of the following controls over all the other tests?

   A. The method of attachment

   B. The adaptation of the item to the property

   C. The relationship of the parties

   D. A written agreement between the parties

3. **5 pts**

   A florist leasing a shop installs refrigerated display cases bolted to the wall. The lease expires, and the florist leaves the cases behind. The cases now belong to the landlord by:

   A. Accession

   B. Severance

   C. Emblements

   D. Adverse possession

4. 5 pts

A tenant farmer plants wheat in the spring. In midsummer the owner, who rented the field to him at will, ends the tenancy. Which statement is MOST accurate?

A. The wheat is real property and belongs to the owner

B. The farmer may return to harvest the wheat as emblements

C. The wheat is fructus naturales

D. The farmer must be paid the market value of the land

5. 5 pts

An owner cuts down a dead walnut tree and stacks the logs to sell. The logs are now:

A. Real property by annexation

B. A fixture

C. Personal property by severance

D. Fructus naturales still attached to the land

6. 5 pts

Which of the following is NOT a physical characteristic of land?

A. Immobility

B. Indestructibility

C. Uniqueness

D. Situs

7. 5 pts

A court orders a seller who refused to close to convey the property to the buyer as agreed. The characteristic of land that BEST justifies this remedy is:

A. Nonhomogeneity

B. Scarcity

C. Permanence of investment

D. Immobility

8. 5 pts

Which of the following is an improvement TO the land rather than an improvement ON the land?

A. A detached garage

B. A barn

C. A sewer line serving the subdivision

D. A backyard fence

9. 5 pts

A spring flood suddenly tears away three acres of a riverside farm and deposits them downstream. This loss of land is called:

A. Avulsion

B. Accretion

C. Reliction

D. Alluvion

10. 5 pts

A valid metes-and-bounds description must:

A. Begin at the corner of a section

B. End at the last monument named

C. Refer to a principal meridian

D. Return to the point of beginning

11. 5 pts

Which of the following is a properly written bearing in a metes-and-bounds description?

A. E 45° N

B. N 95° E

C. S 30° W

D. W 10° S

12. 5 pts

A deed calls for a boundary “thence 300 feet to an iron pin,” but the pin is found 296 feet away. In most cases the boundary runs:

A. To the iron pin, because monuments generally control over distances

B. Exactly 300 feet, because distances control over monuments

C. To a point halfway between

D. Nowhere, because the description is void

13. 5 pts

How many feet are in 30 rods?

A. 330 feet

B. 450 feet

C. 495 feet

D. 1,980 feet

14. 5 pts

Rectangular survey descriptions in both Washington and Oregon are measured from which principal meridian?

A. The Boise Meridian

B. The Willamette Meridian

C. The Principal Meridian Montana

D. The Seward Meridian

15. 5 pts

In a standard township, Section 36 is located in which corner?

A. Northeast

B. Northwest

C. Southwest

D. Southeast

16. 5 pts

How many acres are in the N½ of the SE¼ of the NW¼ of a section?

A. 10 acres

B. 20 acres

C. 40 acres

D. 80 acres

17. 5 pts

A farm is described as “the W½ of the NE¼ and the NE¼ of the SE¼ of Section 8.” How many acres does it contain?

A. 60 acres

B. 100 acres

C. 120 acres

D. 160 acres

18. 5 pts

“Lot 14, Block 2, Cedar Hills Addition, as recorded in Book 9 of Plats, page 31” is an example of which kind of legal description?

A. Lot and block (recorded plat)

B. Metes and bounds

C. Rectangular survey

D. Assessor’s parcel number

19. 5 pts

The owner of a cottage on the shore of a large lake holds which kind of water rights?

A. Riparian

B. Littoral

C. Avulsive

D. Subjacent

20. 5 pts

Under the doctrine of prior appropriation used in the western states:

A. Only owners of land bordering the water may use it

B. All users share water equally in a drought

C. A water right, once granted, can never be lost

D. The first to put the water to beneficial use under state law has the senior right

ANSWER KEY

1. B. Real estate is land plus permanent man-made improvements. Real property adds the bundle of legal rights; land alone includes only natural attachments.
2. D. A written agreement overrides every other test. Absent an agreement, intention is usually considered the most important legal test; method of attachment (A) is only one piece of evidence of intention.
3. A. The cases were trade fixtures, the tenant's personal property, removable before the lease expired; left behind, they become the landlord's by accession. Severance (B) is the opposite process — detaching an item.
4. B. Annual crops produced by labor are emblements (fructus industriales), personal property, and a tenant whose tenancy ends through no fault of his own may return to harvest them. Fructus naturales (C) are trees and perennial plants.
5. C. Cutting the tree severed it from the land, converting real property into personal property. Annexation (A) is the reverse — attaching personal property to land.
6. D. Situs (area preference) is an economic characteristic. The three physical characteristics are immobility, indestructibility and uniqueness.
7. A. Because every parcel is unique (nonhomogeneous), money damages cannot buy an identical substitute, so courts may order specific performance. Scarcity (B) is economic and does not explain why this particular parcel cannot be replaced.
8. C. Infrastructure such as sewers, streets and utilities is an improvement to the land, making it usable for building. Garages, barns and fences are improvements on the land.
9. A. Avulsion is the sudden loss of land by a natural force, and the boundary generally does not move. Accretion (B) and reliction (C) add land gradually; alluvion (D) is the deposited soil itself.
10. D. A metes-and-bounds description must close by returning to the point of beginning. Section corners and meridians (A, C) belong to the rectangular survey, which a metes-and-bounds description may or may not use.
11. C. Bearings begin with north or south, give an angle from 0 to 90 degrees, and end with east or west. A and D start with east or west; B exceeds 90 degrees.
12. A. Monuments generally control over courses and distances, because the parties could see the monument. A small discrepancy does not void a description.

13. C. A rod is 16½ feet: $30 \times 16.5 = 495$ feet. D uses 66 feet, the length of a chain.
14. B. The Willamette Meridian, measured from the Willamette Stone near Portland, governs both states. Idaho uses the Boise Meridian, Montana the Principal Meridian Montana, and the Seward Meridian is one of Alaska's five.
15. D. Section 1 is in the northeast corner, and the numbering snakes back and forth row by row so that Section 36 lands in the southeast corner.
16. B. $640 \times \frac{1}{2} \times \frac{1}{4} \times \frac{1}{4} = 20$ acres. C forgets the half.
17. C. The word "and" creates two parcels: $640 \times \frac{1}{2} \times \frac{1}{4} = 80$ acres plus $640 \times \frac{1}{4} \times \frac{1}{4} = 40$ acres, for 120 acres.
18. A. A lot-and-block description refers to a subdivision plat recorded in the county records. An assessor's parcel number (D) is a tax identifier, not a legal description.
19. B. Littoral rights belong to owners bordering large still or tidal bodies of water — lakes, seas and oceans. Riparian rights (A) concern flowing water such as rivers and streams.
20. D. Prior appropriation is "first in time, first in right," based on beneficial use and a right obtained through the state; unused rights may be lost. A describes the riparian idea, which prior appropriation rejects.

PORTFOLIO PIECE: MY PATHWAY FILE — THE LAND PAGES

Assemble the first section of your Pathway File: the Stays-or-Goes fixture inventory with its five disputed items and contract lines (1.1); the Seven Characteristics field guide to your town, with its two assessor land values labeled as examples (1.2); the Walk the Line metes-and-bounds description of a real lot, plotted to scale with its closure error explained (1.3); My Place on the Grid, with your numbered township, shaded section and full rectangular and lot-and-block descriptions (1.4); and the Three-Dimensional Parcel poster with its dated state water-rights brief (1.5).

Close the section with a one-page cover memo to a pretend first buyer of a rural acreage: in your own words, explain the three ways land is described, the questions you would ask about fixtures, minerals and water before writing an offer, and why a survey is worth its cost. End by quoting Deuteronomy 19:14 and explaining in one sentence what a landmark has to do with the work of a real estate licensee. Date every page.

LOOK FOR	WHAT IT MEANS
Fixture inventory	At least twenty items are classified with the attachment noted for each, the tests are applied in the correct order (agreement first), and the five disputed items each carry a clear inclusion or exclusion line.
Characteristics field guide	All seven characteristics have a genuine local example correctly labeled physical or economic, and the assessor comparison is explained with one named characteristic.
Metes-and-bounds description	The description begins at an identifiable point of beginning, uses properly written bearings, returns to the point of beginning, and is plotted to scale with area, rod and chain conversions correct.
Grid and plat descriptions	The township is numbered correctly from memory, aliquot acreages are correct, and the parcel's meridian, township, range, section and (where applicable) lot-and-block description are written in proper form.
Three-dimensional parcel and water brief	Surface, air, mineral, support and water rights are correctly labeled; the four shoreline changes are drawn with the right ownership result; and the water brief is dated and names its state agency.

LOOK FOR	WHAT IT MEANS
Cover memo	Written in the student's own voice, it explains the three description methods accurately, raises fixtures, minerals and water as pre-offer questions, and connects the landmark verse to honest boundary work without canned language.

UNIT 2

Ownership, Estates and Encumbrances

Unit 1 asked what land is and where it lies. This unit asks the harder question: what, exactly, does an owner own? You will begin with William the Conqueror's commissioners riding from village to village in 1086, and follow the law as it turned feudal holdings into the **estates** you will meet on every exam — the **fee simple absolute**, the defeasible fees with their "so long as" and "but if," and the **life estate** with its remainders and reversions. You will learn what a tenant owns, from the **estate for years** to the holdover **estate at sufferance**, through the story of the old Elgin Garden land in Manhattan, leased in 1928 to the builder of Rockefeller Center.

Then you will see how people own together — in **severalty**, as **tenants in common**, as **joint tenants** with the right of survivorship, and under the **community property** law of Washington and Idaho — and how they own apartments, shares, weeks and trusts. The unit ends with the claims that burden every title: **liens**, from the first mechanic's lien passed for the builders of Washington, D.C., in 1791 to the judgment and tax liens of today; **easements** that let a neighbor cross; and the **encroachments** only a survey can find. Property Ownership is about a tenth of the national exam, and its vocabulary returns in contracts, title and closing — learn it well now.

PREREQUISITES

- Can explain the bundle of rights and name its five rights, from Lesson 1.2
- Can distinguish real property from personal property and define a fixture, from Lesson 1.1
- Can explain why a survey reveals what a title search cannot, from Lesson 1.3
- Has the exam notebook and index-card deck current through Unit 1, with every missed unit-test question corrected

MASTERY CHECKLIST

- ☐ I can define fee simple absolute and tell a fee simple determinable ("so long as," possibility of reverter) from a condition subsequent ("but if," right of re-entry).
- ☐ I can distinguish ordinary and pur autre vie life estates, remainder from reversion, and state a life tenant's rights and duty not to commit waste.
- ☐ I can classify the four leasehold estates and say how each ends, including what happens at a party's death or the sale of the property.
- ☐ I can compare severalty, tenancy in common, joint tenancy (PITT) and tenancy by the entirety, and trace title through a sale or death.
- ☐ I can distinguish community from separate property and name the Northwest's community property states.
- ☐ I can contrast condominiums, cooperatives, PUDs and timeshares, name the parties to a trust, and explain how business entities hold title.
- ☐ I can classify liens three ways and rank lien priority, including the priority of property taxes and special assessments.
- ☐ I can distinguish easements appurtenant and in gross, explain easements by necessity and

prescription, list how easements end, and tell an easement from a license and an encroachment.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Blackstone's Commentaries on the Laws of England (The Avalon Project, Yale Law School)**: Free. The full text of the 1760s treatise that taught American lawyers the law of estates; Book II, chapters 7 through 10, covers freeholds, life estates, estates less than freehold and co-ownership. Dip into it with Lessons 2.1 through 2.3 to read the old definitions in the original. Ages 15 and up.
- **IRS Publication 555: Community Property**: Free, official. The Internal Revenue Service's explanation of community and separate property, with the list of community property states. Read the first sections with Lesson 2.3. Ages 15 and up.
- **Revised Code of Washington, Chapter 26.16 (separate and community property)**: Free, official. Washington's own statute defining separate and community property and the rules for conveying community real property — a model of how a community property state writes the law. Read sections 26.16.010 through 26.16.030 with Lesson 2.3. Ages 16 and up.
- **HUD: Tenant Rights, Laws and Protections**: Free, official. The Department of Housing and Urban Development's gateway to tenant rights, with links to each state's landlord-tenant resources. Use it in Lesson 2.2's project to find your state's official notice rules. Ages 14 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

2.1	**The Bundle of Rights and the Freehold Estates**	3 sessions of 50 minutes
2.2	**Leasehold Estates: What a Tenant Owns**	3 sessions of 50 minutes
2.3	**Owning Together: Severalty, Tenancy in Common and Joint Tenancy**	3 sessions of 50 minutes
2.4	**Condominiums, Cooperatives, Timeshares and Trusts**	3 sessions of 50 minutes

Unit 2 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions in the style of the national exam, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. A score of 70% (14 of 20) matches the common passing line, but aim higher. Figures marked “in this example” are examples. Choose the one BEST answer.

1. **5 pts**

   The most complete form of ownership recognized by law — unlimited in duration, freely transferable and inheritable — is:

   A. Fee simple absolute

   B. Fee simple determinable

   C. A life estate

   D. An estate for years

2. **5 pts**

   A grantor conveys land “to the county so long as it is used as a public park.” Ten years later the county builds a parking garage on it. Which is TRUE?

   A. The grantor must sue to recover the land

   B. The land reverts automatically to the grantor or the grantor’s heirs

   C. The county keeps the land, because the deed was a fee simple absolute

   D. The land escheats to the state

3. **5 pts**

   A deed reads “to Grace for life, then to Henry.” Henry’s interest is BEST described as:

   A. A reversion

   B. A leasehold

   C. A remainder

   D. A possibility of reverter

4. **5 pts**

Owen holds a life estate in a farm “for the life of his grandmother, Ida.” Owen dies, survived by his son; Ida is still living. Which is TRUE?

A. The life estate ends at Owen’s death

B. The farm reverts to the grantor immediately

C. Ida now owns the farm in fee simple

D. Owen’s son holds the life estate until Ida dies

5. **5 pts**

Which of the following may a life tenant NOT do without the consent of the remainderman?

A. Rent the property to a tenant

B. Cut and sell all the mature timber, greatly reducing the land’s value

C. Sell her life estate to a buyer

D. Live on the property

6. **5 pts**

A tenant signs a lease from September 1 through May 31 for an apartment near a college. Which statement is correct?

A. It is an estate for years, and it ends on May 31 without notice from either party

B. It is a periodic tenancy, because it is shorter than one year

C. It is an estate at will, because no renewal is stated

D. The tenant must give 30 days’ notice to end it on May 31

7. **5 pts**

A tenant’s lease expired last week. She remains in the apartment, and the landlord has neither consented nor accepted rent. She holds:

A. An estate for years

B. A periodic estate

C. An estate at will

D. An estate at sufferance

8. 5 pts

Which leasehold estate is ended by the death of either the landlord or the tenant?

A. Estate for years

B. Periodic estate

C. Estate at will

D. Leased fee

9. 5 pts

An investor buys a rental house occupied by a tenant who has eight months left on a written lease. The investor:

A. Must evict the tenant within 30 days of closing

B. May cancel the lease because a sale ends all leases

C. Takes title subject to the lease and must honor it for its remaining term

D. May raise the rent immediately to any amount

10. 5 pts

Ava, Ben and Cole own land as joint tenants. Ava conveys her interest to Dana. Then Ben dies, leaving a will that gives everything to his daughter. The land is now owned by:

A. Cole (two-thirds) and Dana (one-third) as tenants in common

B. Cole and Dana as joint tenants, one-half each

C. Cole, Dana and Ben's daughter, one-third each, as tenants in common

D. Cole alone, in severalty

11. 5 pts

All of the following are among the four unities required for a joint tenancy EXCEPT:

A. Possession

B. Interest

C. Time

D. Use

12. 5 pts

A corporation buys a warehouse in its own name. The corporation holds title:

A. As a joint tenant with its shareholders

B. In severalty

C. As a tenant in common with its officers

D. By the entirety

13. 5 pts

A married couple lives in Idaho. During the marriage, the wife inherits a rental house from her uncle. Under community property law, the rental house is:

A. Community property, because it was acquired during the marriage

B. Owned by the couple as joint tenants

C. Owned by the couple as tenants by the entirety

D. The wife's separate property

14. 5 pts

A buyer of a cooperative apartment receives:

A. A deed to the unit and an undivided interest in the common elements

B. A fee simple interest for one week each year

C. Shares of stock in the corporation and a proprietary lease

D. A leasehold estate from the condominium association

15. 5 pts

A condominium declaration gives Unit 7 a 4% interest in the common elements, in this example. The association levies a $250,000 special assessment to repair the parking garage. Unit 7's share is:

A. $10,000

B. $4,000

C. $6,250

D. $25,000

16. 5 pts

In a trust holding real estate, legal title is held by the:

A. Trustor

B. Trustee

C. Beneficiary

D. Settlor’s heirs

17. 5 pts

A foreclosure sale nets $200,000, in this example. The property is subject to unpaid property taxes of $5,000, a first mortgage recorded in 2018 with a balance of $170,000, and a judgment lien recorded in 2022 for $40,000. How much does the judgment creditor receive?

A. $40,000

B. $25,000

C. $30,000

D. Nothing

18. 5 pts

A court judgment for $15,000 is recorded against a homeowner in his county. The resulting lien is:

A. Voluntary and specific

B. Voluntary and general

C. Involuntary and specific

D. Involuntary and general

19. 5 pts

Lot 2 has a recorded right to use a driveway across Lot 1 to reach the road. Lot 1 is sold to a new owner. Which is TRUE?

A. The easement is appurtenant; it runs with the land, and the new owner of Lot 1 takes subject to it

B. The easement is in gross and ends at the sale

C. The easement was a license and is revoked by the sale

D. Lot 1 is the dominant tenement

20. 5 pts

For twenty years, with the owner’s friendly permission, a neighbor has crossed a corner of the owner’s lot to reach a lake. The statutory prescriptive period in this example is ten years. The neighbor holds:

A. An easement by prescription

B. An easement by necessity

C. A revocable license

D. An easement appurtenant by grant

ANSWER KEY

1. A. Fee simple absolute is the highest estate. A determinable fee can end if its condition is broken, a life estate ends at a death, and an estate for years is a leasehold, not ownership.
2. B. "So long as" creates a fee simple determinable, which ends automatically when the use stops; the grantor's possibility of reverter takes effect without a lawsuit. A describes a condition subsequent ("but if"), where the grantor holds a right of re-entry.
3. C. A third party named to take after a life estate holds a remainder and is the remainderman. A reversion (A) would return the property to the grantor or the grantor's heirs.
4. D. A life estate pur autre vie is measured by another person's life — here Ida's — so it continues after Owen's death and passes to his heirs until Ida dies. A applies to an ordinary life estate measured by the tenant's own life.
5. B. Destroying a major part of the property's value is waste, which harms the remainderman. A life tenant may possess, lease and sell the life estate (A, C, D), though anything she conveys ends when the measuring life ends.
6. A. Any leasehold with a fixed beginning and end is an estate for years, whatever its length, and it ends automatically. B is the classic trap — "years" does not require a year or more.
7. D. A tenant who came into possession lawfully but stays after the lease ends without the landlord's consent is a holdover tenant holding an estate at sufferance. If the landlord accepted rent, a periodic tenancy would commonly arise.
8. C. An estate at will lasts only as long as both parties wish and ends at the death of either. An estate for years and a periodic estate generally bind the parties' heirs and estates; the leased fee (D) is the landlord's interest, not a leasehold.
9. C. Sale does not break the lease: the buyer steps into the landlord's position and takes subject to the tenant's right of possession for the rest of the term, on the lease's terms.
10. A. Ava's conveyance severed her third, so Dana became a tenant in common. Ben and Cole remained joint tenants, so at Ben's death his third passed to Cole by survivorship, defeating the will. Cole holds two-thirds and Dana one-third, as tenants in common.

11. D. The four unities are possession, interest, time and title (PITT). “Use” is not one of them; unity of possession already gives each owner the right to use the whole.
12. B. A corporation is a single legal person, so it owns in severalty — sole ownership. Its shareholders own stock, not the real estate, and a corporation generally cannot be a joint tenant.
13. D. Property acquired during marriage by gift or inheritance is separate property in community property states such as Idaho and Washington. A is the trap: most — but not all — property acquired during marriage is community property.
14. C. In a co-op the corporation owns the building, and the resident owns shares and a proprietary lease — personal property. A describes a condominium; B describes a timeshare estate.
15. A. $0.04 \times \$250{,}000 = \$10{,}000$. Assessments are shared by each unit’s percentage interest in the common elements unless the declaration provides otherwise.
16. B. The trustee holds legal title and manages the property for the beneficiary, who holds the equitable interest. The trustor (also called the settlor or grantor) creates the trust.
17. B. Property taxes are paid first regardless of date ($5,000, leaving $195,000); then the earlier-recorded mortgage ($170,000, leaving $25,000); the judgment creditor receives the remaining $25,000. C forgets the taxes.
18. D. A judgment lien is imposed without the owner’s consent (involuntary) and, once recorded, attaches to all the debtor’s real property in the county (general). A mortgage is the classic voluntary, specific lien.
19. A. An easement benefiting a neighboring parcel is appurtenant and runs with the land; Lot 2 is dominant and Lot 1 servient. Selling the servient parcel does not end it.
20. C. Use with permission is a license, which is revocable and never ripens into a prescriptive easement, because prescription requires hostile use. Necessity (B) requires a landlocked parcel; a grant (D) requires a written conveyance.

PORTFOLIO PIECE: MY PATHWAY FILE — THE OWNERSHIP PAGES

Assemble the ownership section of your Pathway File: the Estates Ladder with its five family deeds and timelines (2.1); the Four Tenancies casebook with your state's official notice rule, dated and sourced (2.2); the Owning Together decision tree with its six title scenarios and the vesting words from a real recorded deed (2.3); the Four Doors In comparison of condominium, co-op, PUD and timeshare, with its pretend budgets, special-assessment computation and chart of trusts and business owners (2.4); and the Encumbrance Report for 14 Orchard Lane, with its classified liens, foreclosure ranking and easement map (2.5).

Close the section with a one-page cover memo to a pretend first client — a family buying a condominium in Washington with their savings. In your own words, explain what they will own and what they will share, how community property affects who signs, what liens and easements the title report and survey may show, and why you will urge them to read the association's budget and to ask an attorney how to hold title. End with Luke 14:28 and one sentence on counting the cost. Date every page.

LOOK FOR	WHAT IT MEANS
Estates ladder and deeds	Every rung shows correct creating words, duration and future interest; the five family deeds use precise granting language; and each timeline names who holds the present and future interests.
Four Tenancies casebook	Each pretend tenant is correctly classified with how the tenancy ends and what happens at death and sale, and the state notice rule is quoted from an official source with the date checked.
Owning Together	The decision tree is accurate, all six title scenarios end with correct fractions and forms of ownership, and the real vesting words are correctly identified with no private names copied.
Four Doors In	The comparison correctly marks each form as real or personal property, the budgets use labeled example figures, the special assessment is computed correctly, and the trust and business-entity chart states how each holds title.
Encumbrance Report	All liens are classified on three axes, the foreclosure ranking puts property taxes first and pays the rest in recording order, and the easement map labels dominant, servient and in-gross easements and the encroachment.

LOOK FOR	WHAT IT MEANS
Cover memo	Written in the student's own voice, it explains condominium ownership and community property accurately, refers title-holding choices to an attorney, and ties the counting-the-cost verse to careful buying without canned language.

2.1 The Bundle of Rights and the Freehold Estates

OBJECTIVES

- Define an estate in land and distinguish freehold estates from leasehold (non-freehold) estates.
- Explain fee simple absolute and the two fee simple defeasible estates, using the words that create them and the future interests that follow them.
- Distinguish an ordinary life estate from a life estate pur autre vie, and a remainder from a reversion.
- State the life tenant's rights and the duty not to commit waste.
- Describe the legal life estates — dower, curtesy and homestead — and explain how modern states have changed them.

> **Warm-up.** Your grandmother says, "I want to give the farm to the church, but only as long as they use it for a church camp." Write down in five minutes what you think should happen if, forty years later, the church stops running the camp. Who should own the farm then, and should anyone have to go to court to make it happen?

WATCH

Freehold Estates Explained: Fee Simple, Defeasible & Life Estate | Real Estate Exam Prep

EXCEL School of Real Estate · 5:32

https://www.youtube.com/watch?v=UTtA9q8snCk

> **WHEN TO WATCH**
> Watch after the big idea; pause at the "so long as" and "but if" slides and write the future interest that follows each before the video names it.

BACKUP VIDEO

Life Estate | Real Estate Exam Concepts Explained

PrepAgent · 4:27

https://www.youtube.com/watch?v=PlJF2OSHKNE

Watch before the practice set if remainder and reversion still blur together; write one example of each in your notebook as you watch.

estate

The degree, quantity, nature and extent of an interest a person holds in real property.

freehold estate

An ownership estate of indeterminate duration — fee simple or life estate — as distinguished from a leasehold, which lasts for a set or terminable period.

fee simple absolute

The highest and most complete estate recognized by law, unlimited in duration, freely transferable and inheritable; also called fee simple or fee.

fee simple determinable

A defeasible fee that ends automatically if a stated condition is violated, created by words such as "so long as," "while" or "during"; the grantor holds a possibility of reverter.

fee simple subject to a condition subsequent

A defeasible fee created by words such as "but if," "provided that" or "on condition that"; if the condition is broken, the grantor must act to retake the property through a right of re-entry (power of termination).

life estate

A freehold estate limited to the lifetime of the owner or of another named person.

pur autre vie

"For the life of another" — a life estate measured by the life of someone other than the life tenant.

remainder

The future interest of a third party (the remainderman) who receives the property when a life estate ends.

reversion

The future interest kept by the grantor or the grantor's heirs, who receive the property back when a life estate ends.

waste

Damage, neglect or misuse of property by a life tenant (or tenant) that harms the interest of the remainderman or reversioner.

legal life estate

A life estate created by law rather than by deed or will — historically dower and curtesy, and today the homestead protection in many states.

homestead

A family's principal residence, protected by state law to a stated value from certain creditors' claims.

CORE IDEAS

The story. At Christmas in 1085, King William of England — the Norman duke who had conquered the country nineteen years before — held court at Gloucester and, as the chronicle says, had "very deep speech" with his counselors about the land: how it was held, and by whom. He then sent commissioners into every shire to find out. They asked, village by village, who held each manor before the Conquest and who held it now, how many plows worked its fields, how many acres of meadow and woodland it had, how many mills and fishponds, how many people, and what it was worth. The answers, written in Latin in 1086, became the great survey the English soon called the Domesday Book, because its findings, like the Last Judgment, could not be appealed. What the commissioners found was a pyramid. The king owned all the land. Great lords held manors from the king in return for service; lesser men held from the lords; and the farmers at the bottom held strips of field from them. No one but the king simply owned land. Everyone else held an interest in it — and the size and duration of that interest is what lawyers still call an **estate**.

How they figured it out. Over the next six centuries the English law of land turned that pyramid of service into a ladder of ownership. A grant of land made in return for service was called a *fee* (from the same root as fief), and a **fee simple** came to mean an estate that could pass to any heirs without limit. In 1290 the statute called *Quia Emptores* let free tenants sell their land without their lord's consent. Lawyers learned to grant smaller estates carved out of the fee: an estate for one person's lifetime, an estate that lasted only "so long as" a condition was kept, an estate that came back to the giver after someone died. In 1660 Parliament abolished most of the old feudal services, and by the time William Blackstone wrote his *Commentaries on the Laws of England* (1765–1769), the estates in land were laid out in the clear categories American lawyers inherited. The new United States adopted the English estates but not the lord above them: American land is **allodial**, owned outright by private persons, subject only to the government's powers of taxation, eminent domain, police power and escheat.

The big idea. An **estate** is the degree, quantity, nature and extent of an interest in real property — how much of the bundle of rights a person holds and for how long. Estates divide into two families. **Freehold estates** last for an indeterminate time — forever, or for someone's life — and are ownership estates. **Leasehold estates**, also called non-freehold estates, are a tenant's right to possess for a period, and are the subject of the next lesson. The largest freehold is the **fee simple absolute**, usually just called fee simple: the most complete ownership the law allows, unlimited in duration, free to be sold, mortgaged, given away or left by will, and inherited by the owner's heirs if there is no will. When an exam says a buyer received "the highest form of ownership," the answer is fee simple absolute. Every other estate is a slice of it, carved out by a deed or will — and the slice always leaves some piece of the fee somewhere, held by the grantor or by someone else, waiting for its turn.

A **fee simple defeasible** is a fee that can be lost — "defeated" — if a condition is broken. There are two kinds, and the exam tells them apart by their words. A **fee simple determinable** uses words of duration: "to the church *so long as* the land is used for a church camp," "*while* used as a school," "*during* its use as a park." The moment the use stops, the estate ends automatically, and the land returns to the grantor or the grantor's heirs, who hold a future interest called a **possibility of reverter**. No one needs to go to court. A **fee simple subject to a condition subsequent** uses words of condition: "to the church, *but if* the land is ever used for commercial purposes, the grantor may re-enter," or "*provided that*" or "*on condition that*." Here the estate does not end automatically. The grantor holds a **right of re-entry**, also called a **power of termination**, and must take action — usually a lawsuit — to get the land back. If the grantor does nothing, the owner keeps it. Remember the pairs: "so long as" → automatic → possibility of reverter; "but if" → grantor must act → right of re-entry.

A **life estate** is a freehold limited to a lifetime. In an **ordinary life estate**, the measuring life is the life tenant's own: "to my sister Ruth for life." In a life estate **pur autre vie** — French for "for the life of another" — it is someone else's: "to my nephew Sam for the life of my mother." If Sam dies before the mother, Sam's heirs hold the estate until she dies. When a life estate ends, the property passes by a future interest. If the deed names a third party — "then to my church" — the church holds a **remainder** and is called the **remainderman**. If the deed names no one, the property returns to the grantor or the grantor's heirs by **reversion.** A life tenant holds real

ownership while alive: he may live on the property, rent it out, collect the rents, and sell or mortgage his life estate — but he can convey only what he has, so a buyer from a life tenant gets an estate that ends at the measuring life's death. In return the life tenant must pay the property taxes, keep the property in reasonable repair and not commit **waste** — he may not tear down the barn, strip the timber or let the house fall apart to the harm of the remainderman. Because a life tenant's interest ends unpredictably, lenders seldom lend on one without the remainderman's signature.

Some life estates are created not by a deed or will but by law. Under the old common law, a widow received **dower**, a life estate in one-third of the land her husband owned during the marriage, and a widower received **curtesy**, a life estate in all his late wife's land if they had had a child. Dower is why, for generations, a buyer insisted that a seller's wife sign the deed even if she was not on the title — her signature released her dower. Most states have since abolished dower and curtesy or replaced them with a surviving spouse's statutory share of the estate, and community property states such as Washington and Idaho handle marital interests differently, as Lesson 2.3 explains; the exam still asks for the definitions. The **homestead** is the modern legal estate the exam emphasizes: a state law protecting a family's principal residence, up to a stated value that varies widely by state, from the claims of certain unsecured creditors. A homestead exemption does not protect against mortgages the family signed, property taxes or, in many states, mechanics' liens. Some states require the owner to record a homestead declaration; others apply it automatically — check the state's rule.

On the exam today. Expect three or four questions. Know the ladder of freeholds: fee simple absolute (the most complete), fee simple defeasible (determinable or condition subsequent), and life estates (conventional or legal). The classic trap is the defeasible pair. "So long as," "while," "during" → determinable → ends automatically → possibility of reverter. "But if," "provided that," "on condition that" → condition subsequent → grantor must act → right of re-entry (power of termination). The second trap is remainder versus reversion: a third party holds a remainder; the grantor or the grantor's heirs hold a reversion. Third: pur autre vie is measured by someone else's life, and the life tenant's heirs can hold it if the life tenant dies first. Fourth: a life tenant can sell, lease or mortgage the life estate but cannot convey more than he has, must pay taxes and repairs, and may not commit waste. Finally,

remember that freehold estates are ownership; a leasehold is not a freehold estate, and a tenant is never a freeholder.

PICTURE STUDY



Domesday Commissioners at Work, A.D. 1086, Ernest Prater, c. 1922 (published) · Illustration (halftone reproduction of a painting) · Published in *Hutchinson's Story of the British Nation*, London
Image: Wikimedia Commons, public domain

Ernest Prater was an English illustrator who drew scenes of history and of war for popular magazines and books in the years around 1900. In this picture, published in the early 1920s, he imagined the moment the Domesday Book was made: a clerk writing in the great register, a royal official questioning a villager, and a mailed Norman knight standing by to make sure the answers were honest. It opens this lesson because the Domesday survey is where English land law begins — with the king asking, of every acre in the realm, who holds it, from whom, and on what terms.

Look closely

- Find the monk writing in the book. Everything said in this field will be written down in Latin and kept for centuries — a record no one could appeal.
- Look at the villager's open hand and the knight's hand on his sword. What does Prater suggest about who held power in the conversation?
- Notice the oxen plowing in the distance. The commissioners counted plow-teams because plows measured how much land a manor actually farmed.
- Look at the thatched cottages behind the men. The people who lived in them held land, but none of them owned it outright as an American owns a fee simple.

Talk about it

1. Under William's system, who "owned" the land the villager farmed? Explain how that differs from a fee simple absolute held by an American family today.
2. The commissioners asked what each manor was worth "then and now." Why would a king want to know the value of land, and which of the government's four powers does that suggest?
3. The Domesday Book was trusted because it recorded the truth about every holding, great and small. Why do honest records protect the weak as well as the strong, and how does that connect to Naboth's refusal to give up his inheritance?

PROJECT

The Estates Ladder and Five Family Deeds

In this project you will build a one-page chart of every freehold estate, then draft the key granting words for five pretend family situations and diagram who holds what today and who will hold it tomorrow. Attorneys draft real deeds and wills; a licensee who can read the granting clause and recognize a life estate or a defeasible fee will spot trouble before a buyer signs.

You will need

- Your exam notebook, ruler and colored pencils
- A large sheet of paper for the chart
- This lesson's key terms and worked examples

Steps

1. Draw a ladder with fee simple absolute at the top, then fee simple determinable, fee simple subject to a condition subsequent, conventional life estate, life estate pur autre vie, and legal life estates at the bottom. Beside each rung write: creating words, duration, and the future interest that follows it (none, possibility of reverter, right of re-entry, remainder or reversion).
2. Write the granting words for five pretend situations: (a) a farmer leaving his farm to his wife for her life and then to their children; (b) a family giving land to a town for a park, to return if the park closes; (c) a donor giving a lot to a church, with the right to take it back if it is ever sold for commercial use; (d) a man giving his nephew a house for the life of the man's mother; (e) a couple selling their home outright.
3. For each, draw a simple timeline: who holds the present estate, who holds the future interest, and what event moves the property from one to the other.
4. For situations (a) and (d), list two things the life tenant may do and one thing that would be waste.
5. Look up whether your state has a homestead exemption and whether it requires a recorded declaration (your state's statutes or a court self-help

page). Write the answer in one sentence, labeled "as of [date]" — and do not copy a dollar amount without the date.

6. Title the chart "The Estates Ladder," date it and file it with the five deeds in your Pathway File.

EXAM NOTEBOOK

1. Flashcards for every key term; put the two defeasible fees on facing cards with their trigger words, the automatic-or-not rule and the future interest that follows each.
2. Draw the freehold family tree: FREEHOLD → fee simple (absolute; defeasible → determinable, condition subsequent) and life estates (conventional → ordinary, pur autre vie; legal → dower, curtesy, homestead).
3. Write a trap list titled "Estates": so long as = automatic = possibility of reverter; but if = must act = right of re-entry; third party = remainder, grantor = reversion; life tenant may sell only what he has; no waste.

> **From history.** Domesday was not the end of English land surveys. In 1873 Parliament published the "Return of Owners of Land," sometimes called the Modern Domesday, the first count of landowners since 1086. It showed that a remarkably small number of families owned most of the land in Britain. In the United States the opposite policy took hold: through laws such as the Homestead Act of 1862, Congress transferred millions of acres of public land in fee simple to ordinary families in small farm-sized parcels.

Example 1. Exam style. A grantor deeds land "to the Cedar Valley School District so long as the land is used for school purposes." Twenty years later the district closes the school and sells the building's furniture. What happens to the land?

A. The district keeps fee simple absolute

B. The land automatically returns to the grantor or the grantor's heirs

C. The grantor may sue to re-enter, but until then the district owns it

D. The land escheats to the state

Show solution

1. Find the creating words: "so long as" — words of duration.
2. "So long as" creates a fee simple determinable, which ends automatically when the stated use ends.
3. The grantor (or heirs) held a possibility of reverter, which now becomes a present estate without any lawsuit.
4. C describes a fee simple subject to a condition subsequent ("but if"); D applies only when an owner dies with no will and no heirs.

Answer: B. A fee simple determinable ends automatically, and the land reverts to the grantor or heirs through the possibility of reverter.

Example 2. Mrs. Alvarez deeds her house “to my son Daniel for the life of my sister Elena, then to the First Baptist Church.” Daniel dies, survived by his daughter Rosa; Elena is still alive. Who owns what now, and what happens when Elena dies?

Show solution

1. Identify the estate: a life estate measured by Elena’s life, not Daniel’s — a life estate pur autre vie.
2. Daniel’s interest does not end at his own death; it lasts until Elena dies, so it passes to Daniel’s heir, Rosa, for the rest of Elena’s life.
3. The church, a third party named in the deed, holds a remainder and is the remainderman.
4. When Elena dies, the life estate ends, and the church takes the property in fee simple.

Answer: Rosa holds the life estate pur autre vie until Elena dies; then the church, as remainderman, owns the house in fee simple.

Example 3. A life tenant on a wooded farm wants to (1) rent the farmhouse to a family, (2) clear-cut and sell all the old-growth timber, and (3) sell his life estate to a neighbor. Which may he do?

Show solution

1. Renting the house: a life tenant has the right of possession and may lease the property and keep the rent, though the lease ends when the life estate ends. Allowed.
2. Clear-cutting the timber: destroying a major part of the property's value harms the remainderman or reversioner. That is waste. Not allowed (unless the deed permits it or the land was already being used as a timber operation).
3. Selling the life estate: a life tenant may sell what he has. The neighbor receives a life estate that still ends when the original measuring life ends.
4. The neighbor cannot receive fee simple, because the life tenant cannot convey more than he owns.

Answer: He may rent the house and sell his life estate (which still ends at the measuring life's death), but clear-cutting the timber would be waste.

PRACTICE

1. Easy What is the highest and most complete form of ownership recognized by law?

   Show answer

   Fee simple absolute — unlimited in duration, freely transferable and inheritable.

2. Easy What is the difference between a freehold and a leasehold estate?

   Show answer

   A freehold is an ownership estate of indeterminate duration (fee simple or life estate); a leasehold is a tenant's right to possess for a period of time and is not ownership of the fee.

3. **Easy** What does “pur autre vie” mean?

Show answer

> “For the life of another” — a life estate measured by the life of someone other than the life tenant.

4. **Medium** A deed reads “to the library, but if the building is ever used for anything but a library, the grantor may re-enter and retake the property.” Name the estate and the grantor’s interest.

Show answer

> Fee simple subject to a condition subsequent; the grantor holds a right of re-entry (power of termination) and must take action to regain the property if the condition is broken.

5. **Medium** A life estate is granted “to Ana for life.” The deed says nothing about who takes after Ana dies. Who receives the property, and what is that interest called?

Show answer

> The grantor or the grantor’s heirs, by reversion. A remainder would require a third party to be named.

6. **Medium** Name three duties of a life tenant.

Show answer

> Pay the property taxes, keep the property in reasonable repair, and not commit waste that harms the remainderman or reversioner.

7. **Medium** What is the difference between a possibility of reverter and a right of re-entry?

Show answer

> A possibility of reverter follows a fee simple determinable and takes effect automatically when the condition is broken; a right of re-entry follows a fee simple subject to a condition subsequent and requires the grantor to act to retake the property.

8. Hard A life tenant sells her life estate to a buyer for $90,000 and then dies two years later. What does the buyer own after her death?

Show answer

Nothing. A life tenant can convey only what she has, so the buyer received a life estate measured by her life; at her death the property passes to the remainderman or reverts to the grantor.

9. Hard Why did buyers historically insist that a seller's wife sign the deed even if she was not on the title?

Show answer

To release her dower — the common-law widow's life estate in a share of land her husband owned during the marriage. Without her release, she could later claim dower in the land the buyer had purchased.

10. Hard Does a homestead exemption protect a family from foreclosure by the lender that holds their home mortgage? Explain.

Show answer

No. A homestead exemption protects the principal residence, up to a stated value, from certain unsecured creditors; it does not protect against the mortgage the family itself signed, property taxes and, in many states, mechanics' liens.

11. Challenge A grantor deeds a farm "to Jonah for life, then to Jonah's children." Jonah's son wants to buy the farm outright from Jonah alone. Explain why he cannot, and whose signatures he would need.

Show answer

Jonah holds only a life estate and cannot convey fee simple; the remainder belongs to Jonah's children as remaindermen. To acquire fee simple, the buyer would need deeds from Jonah (life estate) and from all the remaindermen — and, if any child is a minor or the class could still grow, possibly a court's involvement.

12. **Challenge** Explain in three sentences why an American family's fee simple is called allodial, and what limits still remain on it.

Show answer

In feudal England only the king owned land outright, and everyone else held an estate from a lord in return for service. American land is allodial, meaning it is owned outright by private persons with no lord above them and no service owed. Even so, every owner remains subject to the four powers of government — taxation, eminent domain, police power and escheat.

COMMON MISTAKES

- Swapping the defeasible fees — "so long as" creates a determinable fee that ends automatically; "but if" creates a condition subsequent that requires the grantor to act.
- Calling a third party's future interest a reversion — a third party holds a remainder; only the grantor or the grantor's heirs hold a reversion.
- Thinking a life estate pur autre vie ends at the life tenant's death — it ends at the death of the measuring life, and the life tenant's heirs may hold it until then.
- Believing a life tenant can sell fee simple — he can sell or mortgage only his life estate.
- Treating a homestead exemption as protection from the family's own mortgage lender — it guards against certain unsecured creditors, not voluntary liens or property taxes.
- Calling a leasehold a freehold estate — a tenant possesses but does not hold a freehold.

> **Make it a game · So Long As or But If?.** One player is the grantor and reads granting clauses from cards: "to the town while used as a park," "to Mia for life, then to Leo," "to the church, provided that it is never sold for commercial use," "to my nephew for the life of my mother." Players race to shout the estate. For a bonus point, they must also name the future interest — possibility of reverter, right of re-entry, remainder or reversion — and say AUTOMATIC or MUST ACT where it applies. Wrong answers lose a point. After ten cards, the top scorer becomes the grantor and must write three new clauses on the spot.

Scripture. “And Naboth said to Ahab, The LORD forbid it me, that I should give the inheritance of my fathers unto thee.” (1 Kings 21:3, KJV)

King Ahab wanted Naboth’s vineyard, and Naboth refused to sell, because the land was his family’s inheritance. The story shows that even a king is bound by a citizen’s right to his land — and how terrible it is when power ignores that right. The estates in this lesson are the law’s long effort to say precisely what each person holds, so that no one’s inheritance depends on a ruler’s whim.

2.2 Leasehold Estates: What a Tenant Owns

OBJECTIVES

- Define lessor, lessee, leasehold and leased fee, and explain the landlord's reversionary interest.
- Distinguish the four leasehold estates — estate for years, periodic estate, estate at will and estate at sufferance — by duration, renewal and how each ends.
- State whether death of a party or sale of the property ends each kind of tenancy.
- Explain why a leasehold is personal property (a chattel real) and how a ground lease works.
- Apply the rule that a sale does not break a lease to scenarios involving buyers and tenants.

> **Warm-up.** Write down everything you think a tenant in an apartment "owns" — and everything the landlord still owns. Then answer in two sentences: if the landlord sold the building tomorrow, should the tenant have to move out? Keep your answer to compare with the rule you will learn.

WATCH

Leasehold Estates: Estate for Years, Periodic Tenancy, at Will & at Sufferance

PassBuddy · 17:29

https://www.youtube.com/watch?v=Ks-IycOUIkE

> **WHEN TO WATCH**
> Watch after the big idea; as the instructor builds his chart, copy it into your notebook and add a column of your own for "ends at death?"

BACKUP VIDEO

Types of Leaseholds

firsttuesday – California real estate educators · 2:40

https://www.youtube.com/watch?v=gKvsH4sfAmg

A quick review on practice day — watch it once, then close the video and recite the four leasehold estates and how each one ends.

KEY TERMS

leasehold estate

A tenant's right to possess real property for a period of time under a lease, without ownership of the fee; also called a non-freehold estate.

lessee

The tenant — the party who receives the right of possession under the lease.

reversionary interest

The landlord's right to regain possession of the property when the lease ends.

periodic estate

A leasehold that continues for successive periods (week to week, month to month, year to year) and renews automatically until one party gives proper notice; also called a periodic tenancy or estate from period to period.

estate at sufferance

The lowest leasehold, held by a tenant who stays in possession after the lease ends without the landlord's consent (a holdover tenant).

lessor

The landlord — the owner who grants the lease.

leased fee

The landlord's interest in leased property: ownership of the fee plus the right to rent and the reversion.

estate for years

A leasehold for a definite period with a fixed beginning and end date — of any length, even less than a year — that ends automatically without notice.

estate at will

A leasehold of indefinite duration that continues with the landlord's consent and may be ended by either party with notice or by the death of either party.

chattel real

A personal property interest in real estate; a leasehold is the classic example.

ground lease

A long-term lease of land only, on which the tenant usually builds; the improvements commonly pass to the landowner when the lease ends.

CORE IDEAS

The story. In 1801 a New York physician named David Hosack bought about twenty acres of farmland, far north of the city, and planted the first public botanical garden in the United States, which he called the Elgin Garden. The garden cost more than he could afford, and in 1810 he sold it to the State of New York. In 1814 the state legislature gave the land to Columbia College. For more than a century Columbia kept the land and rented it out. Then in 1928 John D. Rockefeller Jr. signed a lease with Columbia for a three-block portion of the old garden in midtown Manhattan. He planned a new home for the Metropolitan Opera there; when the stock market crashed in 1929 the opera's plans collapsed, and Rockefeller went ahead with a complex of office towers instead. The lease ran for 87 years at about three million dollars a year. Rockefeller Center rose in the 1930s on land its builder did not own. Columbia held the land — and the right to have it back when the lease was over — until 1985, when the university agreed to sell the land under the towers to the center's owners for 400 million dollars.

How they figured it out. The law had been working out what a tenant owns for eight hundred years. In medieval England a lease was not considered an estate in land at all. It was a personal contract, and a tenant thrown off the land by the lord's buyer could sue only for money. Over the fourteenth and fifteenth centuries the royal courts gave tenants the right to recover the land itself, and the lease became a true estate — but a lesser one. Because a tenant's interest lasted only for a term and owed rent to someone else, lawyers classified it not as a freehold but as personal property, and gave it the curious name **chattel real**: a chattel, because it is not ownership of the fee, and real, because it concerns land. The courts also sorted tenancies by how they begin and end: a fixed term, a term that renews itself period by period, a tenancy that lasts only as long as both parties wish, and the status of a tenant who simply stays after his right has ended. Those four categories are exactly the four leasehold estates on the national exam today.

The big idea. A **leasehold estate**, also called a non-freehold estate, is a tenant's right to possess real property for a time. The owner who grants it is the **lessor** (landlord); the person who receives it is the **lessee** (tenant). Remember the -or/-ee rule: the one who gives is the -or; the one who receives is the -ee. The tenant receives possession and the right to use the property during the term — the possession and enjoyment sticks from the bundle — and owes rent and the duties the lease sets out. The landlord keeps the **leased fee**: ownership of the property, the right to receive rent, and the **reversionary interest**, the right to retake possession when the lease ends. Because the leasehold is not ownership of the fee, it is classified as **personal property** — a chattel real — even though it concerns land. That classification explains why a tenant's leasehold may be assigned or inherited like other personal property, and why the leased fee and the leasehold can be valued and sold separately, as Columbia's land and Rockefeller's towers were.

The exam tests four leasehold estates, from strongest to weakest. An **estate for years** (also called a tenancy for years) lasts for a definite period with a fixed beginning and ending date. Despite its name, it can be any length — five years, one year, or six months for a summer rental — so long as the end date is fixed. It ends automatically at the end of the term, and neither party needs to give notice. It is not ended by the death of the landlord or the tenant: the lease binds their estates and heirs for the rest of the term. A **periodic estate** (periodic tenancy, or estate from period to period) runs for a set period — week to week, month to month, year to year — and *renews automatically* at the end of each period until one party gives proper notice to end it. Its key feature is that it has no fixed ending date. It arises by agreement ("month-to-month") or by implication, as when a tenant keeps paying monthly rent after a lease expires and the landlord accepts it. The notice required is set by the agreement and by state law, commonly one full rental period for a month-to-month tenancy; check the state's landlord-tenant statute for the exact rule.

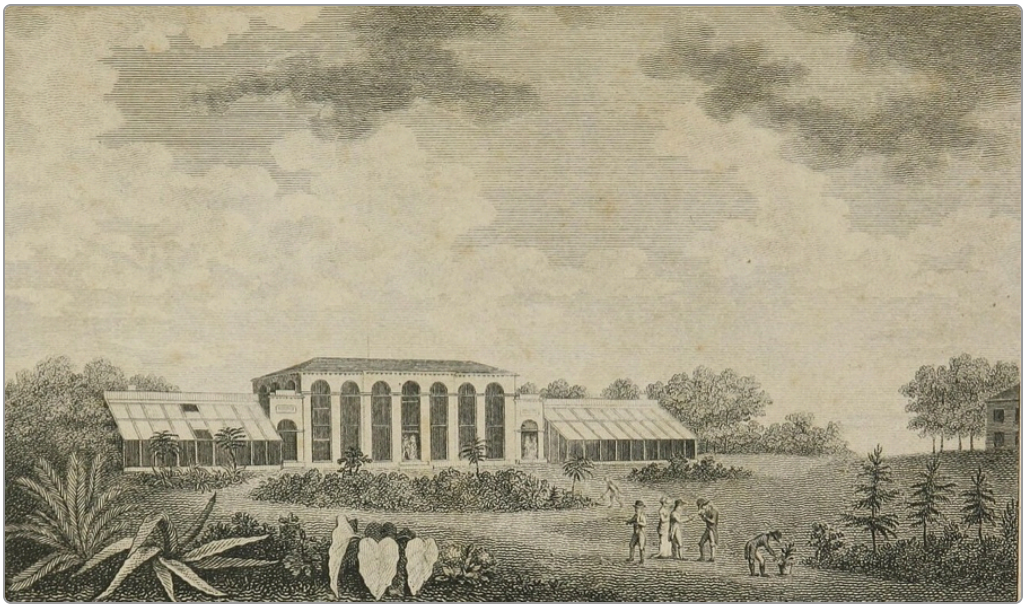
An **estate at will** (tenancy at will) has no fixed term at all. It continues only as long as both parties wish: either may end it, usually with notice required by state law, and it ends automatically at the death of either the landlord or the tenant. A family member allowed to live in a house "until we decide to sell" is a typical tenant at will. The weakest is the **estate at sufferance** (tenancy at sufferance): a tenant who lawfully came into possession stays on after the lease has ended, without the landlord's consent. The tenant at sufferance is a **holdover tenant** and has no estate in the

ordinary sense — only the bare fact of having entered lawfully, which distinguishes him from a trespasser. The landlord may begin eviction under state law, or may accept rent, which commonly converts the holdover into a periodic tenancy. A simple test sorts the four: Is there a fixed end date? Estate for years. Does it renew itself until notice? Periodic. Does it last only as long as both wish, ending at either's death? At will. Did the tenant stay without consent after the lease ended? At sufferance.

What happens when the landlord sells? The general rule is short: **sale does not break the lease.** A buyer takes title subject to the rights of tenants in possession, and a tenant with a valid lease for years keeps possession for the rest of the term, paying rent to the new owner. Buyers therefore must check the leases — the tenant's possession is notice of the tenant's rights, whether or not the lease is recorded. The new owner steps into the landlord's place, and the leased fee changes hands while the leasehold stays put. (A periodic or at-will tenancy may of course be ended by the new owner with proper notice, and an estate at will ends at a sale or the landlord's death in many states.) Long leases of land alone are called **ground leases**: the tenant builds on land it rents, as Rockefeller did, and the buildings commonly belong to the landowner when the lease ends unless the lease says otherwise. Lease *types* — gross, net, percentage, graduated and others — and the full law of landlord and tenant are taught in Lesson 7.5; for now, know that a lease longer than one year must generally be in writing to be enforceable under the statute of frauds.

On the exam today. Expect two or three questions. The core is matching a scenario to one of the four estates: a fixed end date is an estate for years (no notice needed); automatic renewal until notice is a periodic estate; indefinite, ending at either party's wish or death, is an estate at will; staying after the lease ends without consent is an estate at sufferance. Traps: "an estate for years must last more than a year" (no — any definite term counts); "an estate for years ends when the tenant dies" (no — it binds the heirs for the rest of the term); "a periodic tenancy ends automatically" (no — it renews until notice); "the landlord holds the leasehold" (the tenant holds the leasehold; the landlord holds the leased fee and the reversion); and "a sale terminates the lease" (sale does not break a lease). Also know that a leasehold is personal property — a chattel real — and that lessor means landlord and lessee means tenant.

PICTURE STUDY



View of the Botanic Garden at Elgin, in the Vicinity of the City of New York, Drawn by L. Simond; engraved by William Satchwell Leney, Early 1800s · Engraving · Frontispiece to David Hosack's description of the Elgin Garden; copy in the U.S. National Library of Medicine

Image: Wikimedia Commons, public domain

This engraving shows David Hosack's Elgin Botanic Garden as it looked in the first years of the 1800s: a central hall flanked by glass hothouses, set in open country well north of New York City. It was published as the frontispiece to Hosack's own description of his garden. The ground in this picture is the same ground on which Rockefeller Center now stands — land that Columbia owned for 171 years while others built on it under leases. It opens this lesson because it shows the land itself, the thing a landlord keeps even while a tenant builds towers on top of it.

Look closely

- Find the glass hothouses on either side of the central hall. Hosack built them to grow plants from around the world for the study of medicine.
- Look at the open countryside around the garden. In 1801 this was farmland; today it is the middle of Manhattan. Which characteristic of land from Unit 1 explains the change in its value?
- Notice the small figures walking on the lawn. They are visitors, there by permission — not tenants, not owners.

- Compare the building with what stands on the same ground today. The land stayed with one owner through all those changes; the improvements came and went.

Talk about it

1. When Rockefeller leased this land in 1928, what did he own and what did Columbia own? Use the terms leasehold, leased fee and reversion.
2. Why might a landowner such as a university prefer to lease its land for a long term rather than sell it?
3. Hosack built something beautiful and useful that he could not afford to keep, and others carried it forward. What does it mean to be a faithful steward of land you will not hold forever?

PROJECT

The Four Tenancies Casebook

Property managers and listing agents meet all four leasehold estates in a single week. In this project you will build a casebook: four pretend tenants, each holding a different estate, with the documents and decisions each one requires, and a one-page summary of your own state's notice rules taken from an official source.

You will need

- Your exam notebook and a pencil, or free spreadsheet software
- Your state legislature's landlord-tenant statute or the state attorney general's or courts' landlord-tenant guide (free and official)
- This lesson's key terms and worked examples

Steps

1. Invent four pretend tenants of one pretend duplex and garage: one with a two-year lease (estate for years), one month-to-month (periodic), one relative living there by permission with no term (at will), and one whose lease ended last week who has not left (at sufferance).
2. For each, write a half-page case: how the tenancy began, whether it has an end date, how it can be ended, and what happens if the landlord or tenant dies.
3. Add a sale: the owner sells the duplex to a pretend buyer. For each tenant, state whether the tenancy survives the sale and what the buyer must do.
4. Using your state's official landlord-tenant source, record the required notice to end a month-to-month tenancy for an ordinary residential tenant, with the statute or source name and the date you checked. Note any special rules (some states and cities require a reason or longer notice).
5. Draw a one-line diagram for the landlord's side: leased fee + right to rent + reversion; and for the tenant's side: leasehold = possession for a term (chattel real).

6. Title the casebook “The Four Tenancies,” date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Flashcards for every key term; put lessor/lessee on one card with the memory rule “the -or gives, the -ee receives.”
2. Draw a four-row table — for years, periodic, at will, at sufferance — with columns for “fixed end date?”, “renews automatically?”, “notice to end?”, “ends at death?” and fill every cell.
3. Write a trap list titled “Leaseholds”: any definite term is an estate for years; periodic renews until notice; at will ends at death; holdover without consent = sufferance; sale does not break the lease; a leasehold is personal property.

> **From history.** Long leases are an old English habit. The great London estates of the eighteenth century — the Grosvenor estate in Mayfair is the most famous — were built by granting builders leases, commonly for 99 years, under which the builder erected houses and the land and buildings came back to the landowning family when the leases ran out. When those leases expired generations later, families who had lived in the houses for decades found themselves tenants of land they had never owned, and British law eventually gave many long-lease tenants the right to buy their freeholds.

Example 1. Exam style. A tenant signs a lease running from June 1 to August 31 for a summer cottage. On August 31, which is TRUE?

A. The lease renews for another three months unless the landlord gives notice

B. The tenancy ends automatically, without notice from either party

C. The tenant becomes a tenant at will

D. The lease could not be an estate for years, because it was shorter than one year

Show solution

1. Find the dates: a fixed beginning (June 1) and a fixed end (August 31).
2. A leasehold with a definite beginning and end is an estate for years, whatever its length.
3. An estate for years ends automatically at the end of its term; no notice is needed.
4. A describes a periodic estate; D is the classic trap — "years" does not mean the term must be a year or more.

Answer: B. An estate for years ends automatically on its stated end date.

Example 2. A tenant's one-year lease ended on March 31. She stays in the apartment and, on April 1, mails her usual monthly rent check. Classify her tenancy (1) on April 2, before the landlord does anything, and (2) after the landlord cashes the check and says nothing.

Show solution

1. On April 2 her lease has ended and she remains without the landlord's consent: she is a holdover tenant holding an estate at sufferance.
2. The landlord may treat her as a holdover and start eviction under state law — or accept rent.
3. Accepting a monthly rent payment shows consent to a continuing monthly arrangement.
4. In most states that creates a periodic (month-to-month) tenancy, which renews automatically until proper notice is given.

Answer: (1) Estate at sufferance; (2) commonly a periodic, month-to-month tenancy created by the landlord's acceptance of rent.

Example 3. An investor buys a four-unit building. Unit A has a tenant with a written lease running 18 more months; Unit B is month to month; Unit C's tenant is the seller's brother, living there rent-free "as long as it's fine with us"; Unit D is vacant. The investor wants all units empty next month. What can he do?

Show solution

1. Unit A: an estate for years. Sale does not break the lease, so the investor takes subject to it and must honor the remaining 18 months (unless the tenant agrees to leave).
2. Unit B: a periodic estate. The new owner may end it by giving the notice required by the lease and state law.
3. Unit C: an estate at will. It ends at the will of either party and in many states ends upon the sale; at minimum, the new owner may end it with the notice state law requires.
4. Unit D: vacant — no leasehold to address.

Answer: He must honor Unit A's lease for its remaining term; he can end Units B and C with proper notice under state law.

PRACTICE

1. Easy Who is the lessor and who is the lessee?

   Show answer

   The lessor is the landlord, who grants the lease; the lessee is the tenant, who receives possession.

2. Easy Is a leasehold real or personal property?

   Show answer

   Personal property — a chattel real — because the tenant holds possession for a term, not ownership of the fee.

3. Easy Which leasehold estate renews automatically at the end of each period until notice is given?

Show answer

The periodic estate (periodic tenancy, or estate from period to period), such as month to month.

4. Medium A lease runs from January 1 to June 30. Is it an estate for years, and does either party need to give notice to end it?

Show answer

Yes, it is an estate for years, because it has a fixed beginning and end; it ends automatically on June 30 with no notice required.

5. Medium A tenant with three years left on a lease dies. Does the lease end?

Show answer

No. An estate for years is not ended by the death of either party; the lease binds the tenant's estate and heirs for the remaining term (unless the lease says otherwise).

6. Medium What does the landlord hold while a property is leased?

Show answer

The leased fee: ownership of the property, the right to collect rent and the reversionary interest — the right to regain possession when the lease ends.

7. Medium A tenant stays on after her lease expires, and the landlord has not consented or accepted rent. What estate does she hold?

Show answer

An estate at sufferance; she is a holdover tenant, and the landlord may begin eviction under state law.

8. Hard A buyer purchases a rental house with a tenant who has 10 months left on a written lease. The buyer wants to move in next month. What is the rule, and what are the buyer's options?

Show answer

Sale does not break the lease, so the buyer takes title subject to the tenant's right to possession for the remaining 10 months. The buyer must wait, or negotiate with the tenant to leave early (for example, by paying the tenant to surrender the lease).

9. Hard How does an estate at will differ from a periodic estate?

Show answer

A periodic estate has a set period that renews automatically until proper notice and generally survives a party's death; an estate at will has no set period at all, lasts only as long as both parties wish, and ends at the death of either party.

10. Hard In a ground lease, a company leases a vacant lot for 60 years and builds a hotel on it. Who commonly owns the hotel when the lease ends, and why?

Show answer

Commonly the landowner. Improvements attached to the land become part of the real estate, and when the leasehold ends, the landlord's reversion brings back the land with what is on it — unless the lease provides otherwise.

11. Challenge Using the Rockefeller Center story, explain what Columbia owned from 1928 to 1985, what Rockefeller's company owned, and what changed in 1985.

Show answer

Columbia owned the leased fee — the land, the right to rent and the reversion. Rockefeller's company owned the leasehold, the right to possess and build for the 87-year term, a personal-property interest. In 1985 Columbia agreed to sell the land itself, so the leased fee was sold to the center's owners and the landlord-tenant relationship ended.

12. **Challenge** Write three sentences explaining to a nervous tenant why the sale of her building does not mean she must move.

Show answer

Your lease is a legal estate in the property, and a new owner buys the building subject to the rights of the tenants already living there. If you have a lease for a fixed term, you may stay until it ends, and you simply pay rent to the new owner. If you are month to month, the new owner may end the tenancy, but only with the notice your state's law requires.

COMMON MISTAKES

- Thinking an estate for years must last at least a year — any definite term with fixed start and end dates is an estate for years.
- Saying an estate for years requires notice to end — it ends automatically on its end date.
- Believing the death of a party ends an estate for years — only an estate at will ends at a party's death.
- Mixing up lessor and lessee — the lessor (landlord) gives the lease; the lessee (tenant) receives it.
- Assuming a sale terminates existing leases — sale does not break a lease; the buyer takes subject to it.
- Calling a leasehold real property — it is personal property, a chattel real.

> **Make it a game · Which Tenancy?.** Write the four estates on four corners of a room: FOR YEARS, PERIODIC, AT WILL, SUFFERANCE. The caller reads a short scene — "a lease from March 1 to November 30," "month to month since 2019," "your cousin stays in the cabin until you say otherwise," "the lease ended Friday and the tenant is still there." Everyone runs to the right corner; the last to arrive or anyone in the wrong corner is out for the round. Bonus rounds: the caller adds "…and the landlord dies" or "…and the building is sold," and players must shout STAYS or ENDS before running.

Scripture. “According to the number of years after the jubile thou shalt buy of thy neighbour, and according unto the number of years of the fruits he shall sell unto thee: According to the multitude of years thou shalt increase the price thereof, and according to the fewness of years thou shalt diminish the price of it: for according to the number of the years of the fruits doth he sell unto thee.” (Leviticus 25:15–16, KJV)

In Israel a man who “sold” his land really sold its harvests until the Jubilee, when the land returned to his family — something very like a lease for years with a reversion. The price was fair only if it matched the number of years remaining. The same honesty applies to every lease: a term, a price that fits it, and a promise to return what was only lent.

2.3 Owning Together: Severalty, Tenancy in Common and Joint Tenancy

OBJECTIVES

- Define ownership in severalty and distinguish it from concurrent (co-)ownership.
- Compare tenancy in common and joint tenancy by shares, survivorship, transfer by will and the four unities.
- Trace what happens to title when a joint tenant dies, sells or mortgages, including how severance creates a tenancy in common.
- Explain tenancy by the entirety and community property, distinguishing separate from community property and naming the community property states of the Northwest.
- Explain a partition action and when co-owners use it.

> **Warm-up.** Three friends want to buy a cabin together. In five minutes, write down what you think should happen to one friend's share if (a) she dies, (b) she wants to sell, and (c) the other two want to sell but she does not. Keep your answers: this lesson will show you that the deed's wording decides all three.

WATCH

Joint Tenancy VS Tenancy in Common: What's the Difference?

US Realty Training · 5:56

https://www.youtube.com/watch?v=5VBVXFXU0cc

> **WHEN TO WATCH**
> Watch after the big idea; when he explains the four unities, write the PITT letters in your notebook and add one sentence for each before he finishes.

BACKUP VIDEO

Real Estate Exam [National] 18, Tenancy by Entirety and Community Property Explained

Open Exam Prep · 3:59

https://www.youtube.com/watch?v=__tMRATlvOE

Watch after the core ideas for the two married-couple forms; then add one row to your comparison table for each.

severalty

Ownership of real property by one person or one legal entity alone, "severed" from all others.

undivided interest

A co-owner's fractional share in the whole property, with the right to possess and use all of it along with the other co-owners, rather than a separate physical portion.

joint tenancy

Co-ownership with equal undivided interests and a right of survivorship, requiring the four unities of possession, interest, time and title.

four unities

The requirements for joint tenancy: unity of possession, interest, time and title (PITT).

community property

A system, used in states such as Washington and Idaho, under which property acquired by either spouse during marriage is owned equally by both, except separate property.

concurrent ownership

Ownership of the same property by two or more persons at the same time; also called co-ownership.

tenancy in common

Co-ownership in which each owner holds an undivided interest, shares may be unequal, there is no right of survivorship, and each owner may sell, mortgage or will his share.

right of survivorship

The right of surviving joint tenants (or tenants by the entirety) to receive a deceased co-owner's interest automatically, outside of probate.

tenancy by the entirety

A form of co-ownership available only to married couples in states that recognize it, with right of survivorship, in which neither spouse may convey or encumber the property alone.

separate property

In community property states, property owned before marriage or acquired during marriage by gift or inheritance, or bought with separate funds, which belongs to one spouse alone.

partition

A court action by which a co-owner asks to have co-owned property divided, either physically (in kind) or by sale and division of the proceeds.

CORE IDEAS

The story. In the summer of 1886, the photographer Solomon Butcher drove his wagon to a sod house near Lieban Creek in Custer County, Nebraska, and photographed four sisters standing in front of it in their best gingham and percale dresses, with two saddled horses. They were the daughters of a rancher named Joseph Chrisman — Lizzie, Lutie, Hattie and Ruth. The house behind them belonged to Lizzie, the eldest, who had already acquired her own claim under the federal land laws. Her sisters were too young that summer to claim public land, but each of them in time filed a homestead of her own. The records say the sisters took turns staying with one another, so that each could keep her own claim lived on, as the law required. Four sisters, four claims, four separate titles: each held her land alone, though they worked and lived together like one household. Butcher's photograph is one of the most famous images of the American homestead era — and it is also a picture of a question this lesson answers. When people who love one another hold land, do they hold it separately, or together? And if together, what happens when one of them dies?

How they figured it out. English lawyers had answered that question centuries earlier. Around 1481 the judge Thomas Littleton wrote his *Tenures*, the first great textbook of English land law, and in it he described the two main ways several people could hold land at once. In a **joint tenancy**, the owners held the whole together as if they were one owner, and when one died his interest simply vanished, leaving the land to the survivors. In a **tenancy in common**, each owner held his own share, which passed to his heirs at his death. Early English courts preferred joint tenancy, partly because feudal lords found it convenient that land stayed in fewer hands. American legislatures came to prefer the opposite: most states today presume that co-owners who are not married hold as tenants in common unless the deed clearly says otherwise. Two more systems grew up for married couples. The common law created **tenancy by the entirety**, treating husband and wife as a single owner. And from Spanish and French civil law came **community property**, which

treats the earnings of a marriage as belonging equally to both spouses — the system Washington and Idaho follow today.

The big idea. Property owned by one person or one legal entity alone is held in **severalty** — the word means "severed" from others, not "several" owners, and it is the exam's favorite vocabulary trap. A corporation that owns a building owns it in severalty, because the corporation is one legal person. Property owned by two or more persons at once is held in **concurrent ownership**, and each co-owner holds an **undivided interest**: a fractional share of the whole, not a particular room or acre. A one-third owner of a cabin may use the entire cabin along with the others. The two basic forms are tenancy in common and joint tenancy. In a **tenancy in common**, the only required unity is possession — each owner may use the whole property. Shares may be unequal (one-half, one-third, one-sixth), the owners may acquire their shares at different times by different deeds, and there is **no right of survivorship**. Each tenant in common may sell, mortgage, give away or will his share, and when he dies, his share passes to his heirs or devisees through his estate. Tenancy in common is the default form for unmarried co-owners when a deed names several grantees without saying how they hold.

A **joint tenancy** is defined by the **right of survivorship**: when one joint tenant dies, his interest passes automatically to the surviving joint tenants, outside of probate, and his will cannot change that. The last survivor owns the property in severalty. Because survivorship is so powerful, joint tenancy must be created deliberately, with clear words such as "as joint tenants with right of survivorship," and it requires the **four unities** — remembered as PITT. **Possession**: every owner has the right to possess the whole. **Interest**: every owner holds an equal share. **Time**: every owner acquires the interest at the same time. **Title**: every owner acquires by the same deed or will. If any unity is broken, the joint tenancy is broken as to that interest. A joint tenant may sell or give away his interest while alive, but the buyer cannot be a joint tenant, because the buyer's time and title differ; the conveyance **severs** that share, and the buyer becomes a tenant in common with the remaining owners, who stay joint tenants among themselves as to their own shares. In many states a corporation cannot be a joint tenant, because it never dies.

Married couples have two more possibilities, depending on the state. **Tenancy by the entirety**, recognized in a number of states, is available only to a husband and wife and adds a fifth unity — marriage — to the four. It carries a right of survivorship, and

neither spouse may sell or mortgage the property without the other; in most of those states, a creditor of only one spouse cannot reach it. Divorce ends the tenancy by the entirety and generally converts it to a tenancy in common. **Community property** works differently. In a community property state, property acquired by either spouse during the marriage is **community property**, owned one-half by each, no matter whose name is on the title or whose paycheck bought it. **Separate property** — owned before the marriage, received during the marriage by gift or inheritance, or bought with separate funds — belongs to one spouse alone. Nine states are community property states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Alaska allows a married couple to opt in by written agreement or trust. Oregon and Montana are not community property states. Because both spouses own community real property, a licensee in Washington or Idaho should expect both spouses to sign to sell or mortgage it.

Co-owners do not always agree. Any tenant in common or joint tenant may ask a court for **partition**, a lawsuit that divides the property. If the land can be split fairly — a 200-acre farm between two siblings, for example — the court may order **partition in kind**, a physical division. If it cannot — one house among three heirs — the court orders **partition by sale** and divides the proceeds according to each owner's share. (A tenancy by the entirety generally cannot be partitioned while the marriage lasts.) Partition is the law's answer to the warm-up's last question: no co-owner can be forced to stay a co-owner forever. In a transaction, the deed or title report tells you which form the sellers hold; to convey the whole, every co-owner must sign. A licensee should never advise a buyer which form of ownership to choose — that is legal and tax advice for an attorney — but should know enough to recommend that buyers ask before closing.

On the exam today. Expect three or four questions, and several will be scenarios about death or sale. Know the grid: severalty is one owner; tenancy in common has unequal shares allowed, no survivorship, shares pass by will; joint tenancy requires PITT, equal shares and right of survivorship, and cannot be willed. The classic trap is the three-joint-tenant problem: when A conveys to D, D becomes a tenant in common with B and C, who remain joint tenants with each other; if B then dies, C takes B's share by survivorship, and C and D end up as tenants in common, C holding two-thirds. Other traps: "severalty means several owners" (it means one); "a joint tenant's will controls his share" (survivorship beats the will); "community property

includes inheritances" (inheritances are separate property); and "a corporation can hold as a joint tenant" (generally not — it holds in severalty). Remember that Washington and Idaho are community property states, Alaska is opt-in, and Oregon and Montana are not.

PICTURE STUDY



The Chrisman Sisters, Solomon D. Butcher, 1886 · Photograph from a glass-plate negative · History Nebraska, Lincoln; copy in the Library of Congress

Image: Wikimedia Commons, public domain

Solomon D. Butcher (1856–1927) spent decades photographing the settlers of Custer County, Nebraska, hauling his glass-plate camera from farm to farm by wagon. His pictures of sod houses and the families who built them are now among the best records of homestead life. In 1886 he photographed the four Chrisman sisters in front of the eldest sister's sod house. It opens this lesson because it shows people bound together by family who nonetheless held their land separately, each in her own name — and invites the question of how they might have held it together instead.

Look closely

- Look at the house: walls of stacked sod bricks and a roof of earth and grass. On the treeless plains, settlers built with the ground itself.
- Notice the two saddled horses at either end. Sisters living on separate claims miles apart needed horses to visit, work and keep each claim lived on.
- Compare the four dresses — two checked, two patterned. Butcher's notes even recorded the fabrics. Why might a photographer bother to record such details?
- Look at the open prairie behind them. Every acre in this picture was surveyed into sections and quarter sections before it could be claimed.

Talk about it

1. If the four sisters had bought one farm together by one deed, naming no form of ownership, how would they most likely hold it, and what would happen to one sister's share at her death?
2. What would the deed need to say for the sisters to hold as joint tenants, and which four unities would they need?
3. The sisters helped one another keep their separate claims. What does their story suggest about the difference between owning together and helping one another, and how did the daughters of Zelophehad seek a fair inheritance for their family?

PROJECT

The Co-Ownership Decision Tree and Title Scenarios

In this project you will build a decision tree that classifies any form of ownership from the words of a deed, then work six pretend title scenarios through deaths and sales. You will finish by reading the vesting language — the words that say how owners hold title — on a real recorded deed in your county, copying only the vesting words.

You will need

- Your exam notebook and a large sheet of paper
- Colored pencils
- Your county recorder's or auditor's website (free and public)
- This lesson's worked examples

Steps

1. Draw a decision tree that starts with "How many owners?" One → severalty. More than one → "Married?" and "What words?" → tenancy in common, joint tenancy, tenancy by the entirety (where recognized) or community property (in community property states).
2. At each ending, list the form's key traits: shares equal or unequal, survivorship or not, passes by will or not, unities required.
3. Work six pretend scenarios, drawing a before-and-after ownership box for each: (1) three joint tenants, one sells; (2) the same, then one of the original two dies; (3) tenants in common with 50/30/20 shares, one dies with a will; (4) a married couple in Idaho buys with wages and one spouse inherits land; (5) a corporation buys a warehouse; (6) two siblings who inherited a house cannot agree on selling.
4. For scenario 6, explain partition in kind and partition by sale and say which a court would likely order.
5. On your county recorder's site, find any recent deed and copy only its vesting words (for example, "as joint tenants with right of survivorship" or "a married couple as community property"). Identify the form of ownership. Do not copy names.

6. Title the page “Owning Together,” date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Flashcards for every key term; make a PITT card with possession, interest, time and title written out and one sentence for each.
2. Draw a comparison table with four columns — tenancy in common, joint tenancy, tenancy by the entirety, community property — and rows for “who may hold,” “shares,” “survivorship,” “can one owner sell alone?” and “passes by will?”.
3. Write a trap list titled “Co-Ownership”: severalty = one owner; survivorship beats the will; a buyer from a joint tenant is a tenant in common; gifts and inheritances are separate property; WA and ID community property, AK opt-in, OR and MT not.

> **From history.** Solomon Butcher hoped to publish a history of Custer County illustrated with his photographs, and in 1901 he finally did — after an 1899 fire burned his home and his first manuscript of the settlers’ life stories, which he patiently gathered again. His glass-plate negatives, stored separately in a grain shed, survived. The state historical society later bought them, and today they are among the most reproduced photographs of the homestead West, still teaching how families claimed, built on and held the land.

Example 1. Exam style. Ann, Ben and Cal own a lake lot as joint tenants. Ann sells her interest to Dee. Then Ben dies, leaving a will that gives everything to his son. Who owns the lot, and how?

A. Dee and Ben's son as tenants in common, each with one-half

B. Cal and Dee as joint tenants, each with one-half

C. Cal owns two-thirds and Dee one-third, as tenants in common

D. Cal, Dee and Ben's son as tenants in common, one-third each

Show solution

1. Ann's sale breaks the unities of time and title for her share: Dee holds one-third as a tenant in common. Ben and Cal remain joint tenants with each other as to the other two-thirds.
2. When Ben dies, his share passes by survivorship to his fellow joint tenant, Cal — not by his will, so his son receives nothing.
3. Cal now holds two-thirds (his own third plus Ben's third), and Dee holds one-third.
4. Cal and Dee hold as tenants in common, because Dee was never a joint tenant.

Answer: C. Cal owns two-thirds and Dee one-third, as tenants in common; survivorship defeated Ben's will.

Example 2. Three cousins buy a rental house by one deed “to Mia, Noah and Owen,” with no other words. Mia paid half the price and the brothers a quarter each, and the deed says nothing about shares. Mia dies with a will leaving everything to her husband. What did the cousins hold, and who owns Mia’s interest?

Show solution

1. The deed names several unmarried grantees without words of survivorship. In most states that creates a tenancy in common by default.
2. Tenants in common may hold unequal shares. Absent words in the deed, many states presume equal shares, though evidence of unequal contributions can matter — an attorney’s question.
3. There is no right of survivorship in a tenancy in common, so Mia’s interest passes under her will.
4. Her husband becomes a tenant in common with Noah and Owen.

Answer: A tenancy in common; Mia’s interest passes by her will to her husband, who becomes a tenant in common with her cousins.

Example 3. A married couple lives in Washington. During the marriage they bought a house with their wages, titled only in the husband's name. Before the marriage the wife owned a cabin, and during the marriage she inherited a lot from her aunt. Classify each property, and say who must sign to sell the house.

Show solution

1. Washington is a community property state.
2. The house was bought during the marriage with earnings: community property, owned half by each spouse, even though only the husband's name is on the title.
3. The cabin was owned before the marriage, and the lot was inherited during it: both are the wife's separate property.
4. Because the house is community real property, both spouses should expect to sign to sell or mortgage it.

Answer: The house is community property (both should sign to sell); the cabin and the inherited lot are the wife's separate property.

PRACTICE

1. Easy What does ownership in severalty mean?

   Show answer

   Ownership by one person or one legal entity alone — "severed" from others, not owned by several people.

2. Easy What are the four unities required for joint tenancy?

   Show answer

   Possession, interest, time and title (PITT).

3. Easy Which Northwest states are community property states?

   Show answer

   Washington and Idaho. Alaska lets couples opt in by agreement or trust; Oregon and Montana are not community property states.

4. Medium Can tenants in common hold unequal shares? Can joint tenants?

Show answer

Tenants in common may hold unequal shares; joint tenants must hold equal shares because of the unity of interest.

5. Medium Two joint tenants own a house. One dies with a will leaving everything to a charity. Who owns the house?

Show answer

The surviving joint tenant, in severalty. The right of survivorship passes the deceased owner's interest automatically and overrides the will.

6. Medium In a community property state, is a house a wife inherited from her father during the marriage community or separate property?

Show answer

Separate property. Property acquired by gift or inheritance during marriage belongs to the spouse who received it.

7. Medium A corporation buys an office building. How does it hold title?

Show answer

In severalty, because the corporation is a single legal entity, even though it has many shareholders.

8. Hard Four joint tenants — W, X, Y and Z — own land. W sells to Q. Then X dies. Describe the ownership.

Show answer

Q holds one-fourth as a tenant in common. After X dies, Y and Z take X's share by survivorship and hold three-fourths as joint tenants with each other (three-eighths each), and that block is held as tenants in common with Q.

9. Hard How does tenancy by the entirety differ from joint tenancy?

Show answer

Tenancy by the entirety is available only to married couples, adds the unity of marriage, and neither spouse can convey or encumber the property alone; in most recognizing states a creditor of one spouse cannot reach it. A joint tenant may convey his share alone, which severs the joint tenancy.

10. Hard Three heirs own a single house as tenants in common; one wants to sell and the others refuse. What can she do, and what will a court likely order?

Show answer

She may file a partition action. A single house cannot be fairly divided physically, so a court would likely order partition by sale and divide the proceeds according to each heir's share.

11. Challenge Explain why a buyer from a joint tenant cannot become a joint tenant, naming the unities involved.

Show answer

Joint tenants must acquire their interests at the same time and by the same deed. A buyer acquires later and by a different deed, so the unities of time and title are broken; the buyer becomes a tenant in common with the remaining owners.

12. Challenge A Washington couple asks you, as a future licensee, whether they should take title as community property or some other way. Write two sentences on what you would say.

Show answer

The choice of how to hold title has legal and tax consequences, especially at death and divorce, so you should ask a real estate attorney or tax professional before closing. I can show you how the vesting language will read on the deed, but I cannot advise you which form to choose.

COMMON MISTAKES

- Thinking severalty means several owners — it means one owner, severed from all others.
- Letting a joint tenant's will control his share — the right of survivorship passes it to the surviving joint tenants regardless of the will.
- Making the buyer from a joint tenant a new joint tenant — the buyer becomes a tenant in common, because time and title differ.
- Assuming tenants in common must hold equal shares — unequal shares are allowed; equal shares are required only of joint tenants.
- Treating inheritances and gifts as community property — they are separate property of the spouse who received them.

- Listing Oregon or Montana as community property states — in the Northwest only Washington and Idaho are, and Alaska is opt-in.

Make it a game · Survivor Title. Give four players cards reading "Joint Tenant." The caller narrates events: "Player 2 sells to Grandma!" (Grandma gets a "Tenant in Common" card and Player 2 sits out), "Player 3 passes away and wills his share to the dog!" (the cards go to surviving joint tenants, not the dog), "Player 1 divorces" (ignore — they are not married), and so on. After each event, everyone must call out who owns what fraction and how. A wrong call costs a point. The round ends when one owner holds everything in severalty. Then play again with a married couple and community property rules.

Scripture. "The daughters of Zelophehad speak right: thou shalt surely give them a possession of an inheritance among their father's brethren; and thou shalt cause the inheritance of their father to pass unto them." (Numbers 27:7, KJV)

Five sisters whose father died without sons asked Moses whether their family's land would be lost. God answered that they spoke rightly and that the inheritance should pass to them. Questions of who holds family land, and how it passes at death, are as old as Israel's tribes — and the law of co-ownership exists to answer them justly before the grief comes.

2.4 Condominiums, Cooperatives, Timeshares and Trusts

OBJECTIVES

- Explain condominium ownership — the unit in fee simple, the undivided interest in common elements, limited common elements and the documents that create a condominium.
- Contrast a cooperative with a condominium, including the stock-and-proprietary-lease structure and why co-op ownership is personal property.
- Distinguish a timeshare estate from a timeshare use, and a planned unit development from a condominium.
- Identify the parties to a trust and describe living, testamentary and land trusts.
- Explain how corporations, partnerships, limited liability companies, syndicates and joint ventures hold title, and define a REIT.

> **Warm-up.** Picture a twelve-story apartment building. In five minutes, list every part of it that someone has to own: the apartments, the roof, the elevator, the hallway carpet, the parking spaces, the land under it. Then write down who you think should own each part if every family wanted to own its own home inside the building.

WATCH

Condominiums vs. Cooperatives for the Real Estate Exam

Global Real Estate School · 20:12

https://www.youtube.com/watch?v=uChZuyyO31E

> **WHEN TO WATCH**
> Watch after the big idea with your comparison table open; fill in the condominium and cooperative columns as he explains each, and mark any point he makes that this lesson does not.

BACKUP VIDEO

Timeshares

NCREC · 3:37

https://www.youtube.com/watch?v=fXGhxhPAoU0

A short explainer from a state real estate commission; watch it with the timeshare paragraph, noting that the cancellation period it mentions is that state's rule and yours may differ.

KEY TERMS

condominium

A form of ownership in which each owner holds a unit in fee simple plus an undivided interest, as a tenant in common, in the common elements.

common elements

The parts of a condominium owned jointly by all unit owners — land, exterior walls, roof, hallways, elevators, grounds and shared facilities.

limited common elements

Common elements reserved for the use of one or some units, such as an assigned balcony, patio, storage locker or parking space.

declaration

The recorded document (sometimes called the master deed) that creates a condominium, describes the units and common elements and sets each unit's percentage interest.

cooperative

A form of ownership in which a corporation owns the building and residents own shares of stock entitling them to a proprietary lease of their units.

proprietary lease

The long-term lease a cooperative corporation gives each shareholder for a particular unit.

timeshare

The right to use a property for a stated period each year, held either as a timeshare estate (fee ownership of an interval) or a timeshare use (a right to use with no ownership).

planned unit development (PUD)

A development in which owners hold their lots and homes in fee and an owners' association owns and manages the common areas.

trust

An arrangement in which a trustor conveys property to a trustee, who holds legal title and manages it for the benefit of a beneficiary.

land trust

A trust in which real estate is the only asset, the trustee holds title of record, and the beneficiary controls the property and holds a personal-property interest.

limited liability company (LLC)

A business entity whose members are protected from personal liability for its debts and whose income generally passes through to the members for tax purposes.

real estate investment trust (REIT)

A company that owns or finances income-producing real estate and, to qualify for its special tax treatment, distributes most of its taxable income to shareholders.

CORE IDEAS

The story. For most of American history you could own a house, but you could not own an apartment. The law knew how to divide land side by side, not one floor above another. A family in a city apartment building could rent its home or, in New York, buy shares in a cooperative apartment house — but the family did not own its rooms as real estate, and a bank could not easily lend against them. In 1958 Puerto Rico passed a Horizontal Property Act, so named because it divided property in horizontal layers, allowing each apartment in a building to be owned separately.

Three years later Congress added Section 234 to the National Housing Act in the Housing Act of 1961, allowing the Federal Housing Administration to insure mortgages on individual condominium units in any state whose law recognized them. Hawaii moved at once and became the first state to qualify. Utah adopted its condominium act in 1963, and by the end of the decade every state had a condominium statute. Within a generation, millions of families owned homes this way.

How they figured it out. The idea itself was very old. In many European cities, buildings had long been divided among owners floor by floor; in Edinburgh, for centuries, families owned their own flats in the tall stone tenements called "lands," while the law of the tenement set rules for the shared roof, stair and walls. American lawyers in the 1950s and 1960s borrowed the same solution and gave it a statutory frame. The building and land would be divided into *units*, each owned separately in fee simple, and *common elements*, owned by all the unit owners together. A recorded **declaration** would create the condominium and fix each unit's percentage share of the common elements; bylaws would set up an owners' association to run it; and covenants, conditions and restrictions would govern how owners use their units. Separate deeds, separate mortgages and separate tax bills for each unit followed. The cooperative remained as an older alternative, built not on real property law but on corporate law. And for families who wanted to share a vacation home, developers soon adapted both ideas to time — selling a week at a time.

The big idea. A **condominium** owner holds two things. First, the **unit** itself — the airspace within the unit's walls, floor and ceiling — owned in fee simple, with its own deed, mortgage and property tax bill. Second, an **undivided interest**, as a tenant in common with all other unit owners, in the **common elements**: the land, the structure, the roof, hallways, elevators, grounds and amenities. Some common elements are **limited common elements**, reserved for one unit or a few — an assigned parking space, a balcony, a storage locker. A condominium is created by recording a **declaration** (sometimes called a master deed), with a plat or plans of the units; it is governed by **bylaws** and by **CC&Rs** (covenants, conditions and restrictions), and it is run by an owners' association with an elected board. Each owner pays **assessments** — regular monthly fees for upkeep, insurance of the common elements and reserves, and occasional **special assessments** for major

repairs. Unpaid assessments can become a lien on the unit, and the association can foreclose under state law.

A **cooperative** (co-op) is built differently. A corporation owns the land and building, holds a single blanket mortgage on it and pays its property taxes. Residents do not own their units; they buy **shares of stock** in the corporation, and with the shares comes a **proprietary lease** giving the right to occupy a particular unit. Because the resident owns stock and a lease, a co-op interest is **personal property**, not real property — a favorite exam point. Each shareholder pays a monthly charge covering his share of the corporation's mortgage payment, taxes and operating costs. Co-op boards commonly must approve a buyer before shares are transferred (within the limits of fair housing law), and shareholders depend on one another: if some stop paying, the others must cover the blanket mortgage and taxes. Compare a **planned unit development** (PUD): each owner holds his lot and house in fee, and an owners' association — not the owners as tenants in common — owns the common areas such as parks and pools. A **townhouse** describes a building style, not a form of ownership; townhouses may be condominiums, PUD lots or ordinary fee simple lots.

A **timeshare** divides ownership by time: a buyer acquires the right to use a resort unit for a set interval, commonly one week each year. In a **timeshare estate**, the buyer receives a fee simple interest in the unit for that interval, conveyed by deed — real property, often with the buyer as a tenant in common for the year's other weeks. In a **timeshare use** (also called a right-to-use), the buyer receives only a contractual right to occupy for a set number of years, with no ownership — a personal-property interest more like a lease or license. Many states regulate timeshare sales and give buyers a short statutory cancellation period. Ownership can also be held for others. In a **trust**, a **trustor** (grantor or settlor) conveys property to a **trustee**, who holds legal title and manages it for a **beneficiary**, who holds the equitable, beneficial interest. A **living trust** (inter vivos trust) is created during the trustor's life, often to avoid probate; a **testamentary trust** is created by a will and takes effect at death. In a **land trust**, real estate is the only asset, the trustee holds record title, and the beneficiary keeps control and a personal-property interest — useful for privacy.

Businesses own real estate too, and each form holds title differently. A **corporation** is a legal person; it holds title in severalty in its own name, its shareholders own stock (personal property). A **general partnership** is an association of two or more people as co-owners of a business; it may hold real estate in its own name under most

states' partnership laws, and general partners share management and unlimited personal liability. A **limited partnership** has at least one general partner, who manages and bears unlimited liability, and limited partners, who invest money, do not manage and risk only what they invested. A **limited liability company** (LLC) combines the liability protection of a corporation with pass-through tax treatment, and it holds title in its own name; its owners are called members. A **syndicate** is a group of investors pooling money, organized as a partnership or LLC; a **joint venture** is a partnership for one project or a limited time. Finally, a **real estate investment trust** (REIT), authorized by Congress in 1960, lets investors buy shares in income-producing real estate and must distribute at least 90 percent of its taxable income to keep its tax treatment.

On the exam today. Expect three questions or more. The classic comparison: a condominium owner holds the unit in *fee simple* (real property) plus an undivided interest in the common elements as a tenant in common; a cooperative owner holds *stock and a proprietary lease* (personal property). Traps: "a co-op owner receives a deed to the unit" (no — stock and a lease); "a condo owner owns the hallways in severalty" (no — they are common elements owned as tenants in common); "a balcony assigned to one unit is a general common element" (limited common element); "a PUD owner owns the pool as a tenant in common" (the association owns it); and "a timeshare use is real property" (only a timeshare estate is). For trusts, remember the cast: trustor creates, trustee holds legal title, beneficiary benefits. For business entities, remember that a corporation holds in severalty, limited partners are passive and liable only for their investment, LLC members have liability protection, and a joint venture is for one project.

PICTURE STUDY



View of the High Street, Looking East, from the Lawnmarket, Edinburgh, Jane Stewart Smith, Late nineteenth century · Oil painting · City Art Centre, Edinburgh

Image: Wikimedia Commons, public domain

Jane Stewart Smith (1839–1925) devoted much of her life to painting and drawing the old streets of Edinburgh before they were rebuilt, leaving a valuable record of the city's Old Town. Here she looks down the Lawnmarket and High Street toward the crown spire of St Giles'. The tall buildings lining the street were the famous tenements — "lands," as Edinburgh called them — where for centuries each floor or flat could belong to a different family, all sharing one roof, one stair and one set of walls. It opens this lesson because it shows, long before American condominium law, people owning homes stacked one above another.

Look closely

- Count the stories in the tall building on the left. Each floor might hold several separately owned flats.
- Find the laundry and flags hanging from upper windows. Every household had its own window — but whose was the wall it hung from?
- Look at the shops at street level and the homes above. Mixed use in one building is common in condominiums today.
- Follow the street to the spire of St Giles' at the far end. Shared streets, shared stairs and shared roofs required rules everyone would keep.

Talk about it

1. If one of these Edinburgh buildings were made a modern American condominium, which parts would be units and which would be common elements? Name one possible limited common element.
2. Why does a shared roof make neighbors depend on one another, and how do assessments and an owners' association answer that problem?
3. Our Lord commends the builder who counts the cost before building. How does a careful buyer of a condominium or co-op "count the cost" before signing, and why is that wise rather than suspicious?

PROJECT

Four Doors In: A Buyer's Comparison of Condo, Co-op, PUD and Timeshare

A young couple asks you what they would actually own if they bought a condominium, a co-op, a townhouse in a planned development, or a week at a beach resort. In this project you will build the one-page comparison a careful licensee would hand them, with a pretend budget showing what each choice costs every month — and a short guide to who holds title when property is owned through a trust or a business.

You will need

- Free spreadsheet software or ruled paper
- Your exam notebook
- A real condominium or HOA document if your family has one (optional), or a sample declaration from a public library or county recorder

Steps

1. Make a table with four columns — condominium, cooperative, PUD, timeshare estate — and rows for: what the buyer receives (deed, stock and lease, interval deed), real or personal property, who owns the common areas, who pays the property tax, how it is financed, who must approve a buyer, and monthly costs.
2. Write a pretend monthly budget for each, using labeled example numbers: a condo with a mortgage payment, assessment and tax; a co-op with a single monthly charge that includes a share of the blanket mortgage and taxes; a PUD with a mortgage, tax and association dues; a timeshare with an annual maintenance fee divided by twelve.
3. Add a special-assessment scenario: a $150,000 roof repair in a 30-unit condo where each unit holds an equal share. Compute each owner's portion.
4. List five documents a buyer should read before buying into any association (declaration, bylaws, CC&Rs, budget and reserve study, meeting minutes) and say in one line what each reveals.

5. Draw a small chart of trusts (trustor, trustee, beneficiary; living, testamentary, land trust) and business owners (corporation, general and limited partnership, LLC, syndicate, joint venture), with how each holds title.
6. Title the page “Four Doors In,” date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Flashcards for every key term; make one card with CONDO on one side (unit in fee + common elements as tenants in common = real property) and CO-OP on the other (stock + proprietary lease = personal property).
2. Draw a cross-section of a three-story condominium and color the units one color, the general common elements a second and the limited common elements (balconies, parking) a third.
3. Write a trap list titled “Shared Ownership”: co-op = stock and lease, personal property; PUD common areas owned by the association; timeshare estate real, timeshare use not; trustee holds legal title; corporation holds in severalty; limited partners do not manage.

> **From history.** Cooperative apartments came to New York in the 1880s, when the architect Philip Hubert designed buildings in which tenant-owners bought shares and occupied their own apartments; he called them “Home Clubs.” Many early cooperatives failed in hard times, because one blanket mortgage tied every shareholder to the others — exactly the weakness the exam asks about. The cooperative survived anyway, and in New York City it remains a very common way to own an apartment, while most of the country adopted the condominium after 1961.

Example 1. Exam style. A buyer purchases an apartment and receives shares of stock and a long-term lease of her unit. She owns:

A. A condominium unit in fee simple

B. Personal property in a cooperative

C. A timeshare estate

D. An undivided interest as a tenant in common in the building

Show solution

1. Identify the documents: shares of stock and a long-term lease — the hallmarks of a cooperative.
2. In a co-op the corporation owns the building; the resident owns stock plus a proprietary lease.
3. Stock and a lease are personal property, not real property.
4. A describes a condo (deed to a unit); D describes the condo owner's interest in common elements; C is ownership of a time interval.

Answer: B. She holds personal property — shares and a proprietary lease — in a cooperative.

Example 2. In a 40-unit condominium, the declaration gives Unit 12 a 2.5% interest in the common elements, in this example. The association levies a special assessment of $200,000 to replace the roof. How much does Unit 12 owe, and what happens if the owner never pays?

Show solution

1. Assessments are shared by each unit's percentage interest unless the declaration says otherwise.
2. Unit 12's share: $0.025 \times \$200{,}000 = \$5{,}000$.
3. An unpaid assessment can become a lien on the unit under the declaration and state law.
4. The association may enforce the lien, ultimately by foreclosure, according to state law; other owners' units are not affected.

Answer: Unit 12 owes $5,000; if unpaid, the association can record a lien and enforce it against that unit under state law.

Example 3. The Patel family wants to keep their rental duplex out of probate and to keep running it themselves while they live. Their attorney suggests a living trust. Name the parties and say who holds what title.

Show solution

1. The Patels, who create the trust and convey the duplex into it, are the trustors (grantors or settlors).
2. If they name themselves as trustees, they hold legal title as trustees and keep managing the property.
3. They are also the beneficiaries during their lifetimes, holding the equitable interest; their children are typically named as later beneficiaries.
4. Because the trust, not the individual Patels, holds title, the duplex can pass to the children under the trust terms without probate.

Answer: The Patels are the trustors and (in this example) also the trustees and lifetime beneficiaries; the trustee holds legal title, and the beneficiaries hold the equitable interest.

PRACTICE

1. Easy What two things does a condominium owner own?

Show answer

The unit in fee simple and an undivided interest, as a tenant in common with the other owners, in the common elements.

2. Easy What does a cooperative resident receive when buying in?

Show answer

Shares of stock in the corporation that owns the building and a proprietary lease for a particular unit.

3. Easy Name the three parties to a trust.

Show answer

The trustor (grantor or settlor), who creates it; the trustee, who holds legal title and manages the property; and the beneficiary, who benefits from it.

4. Medium Is a parking space assigned to only one condominium unit a common element? Explain.

Show answer

It is a limited common element — part of the common elements owned by all, but reserved by the declaration for one unit's use.

5. Medium Why is a co-op interest considered personal property?

Show answer

Because the resident owns shares of stock and a lease, not the real estate itself; the corporation owns the land and building.

6. Medium What document creates a condominium, and where is it recorded?

Show answer

The declaration (sometimes called the master deed), recorded in the county records along with the plans or plat of the units.

7. Medium In a planned unit development, who owns the community pool?

Show answer

The owners' association. PUD owners hold their own lots in fee and are members of the association that owns the common areas.

8. Hard Several co-op shareholders stop paying their monthly charges. Why does this threaten the other shareholders more than a few defaults would threaten condo owners?

Show answer

The co-op corporation owes one blanket mortgage and one tax bill for the whole building; if some shareholders stop paying, the others must cover the shortfall or the corporation can lose the building. In a condominium, each unit has its own mortgage and tax bill, so one owner's default affects only that unit (apart from unpaid assessments).

9. Hard Distinguish a timeshare estate from a timeshare use.

Show answer

A timeshare estate is a fee simple interest in a unit for a recurring time interval, conveyed by deed — real property. A timeshare use is a contractual right to occupy for set periods over a number of years, with no ownership interest — personal property.

10. Hard In a limited partnership that owns an apartment complex, who manages, and who is liable for the partnership's debts beyond their investment?

Show answer

The general partner manages and bears unlimited liability; the limited partners do not manage and risk only the amount they invested.

11. Challenge A 50-unit condominium assigns equal shares, in this example. A $350,000 special assessment is levied for elevator replacement. What does each owner owe, and why should a buyer read the association's reserve study before buying?

Show answer

$\$350{,}000 \div 50 = \$7{,}000$ per unit. A reserve study shows whether the association is saving enough for major replacements; weak reserves mean a buyer may face large special assessments soon after closing.

12. **Challenge** Explain why the 1961 federal change in mortgage insurance helped condominiums spread across the country.

Show answer

Section 234 let the Federal Housing Administration insure mortgages on individual condominium units in states whose law recognized them. Because each unit could now be separately financed with insured mortgages, lenders were willing to lend, states rushed to pass condominium statutes, and buyers could purchase apartments as real property.

COMMON MISTAKES

- Saying a co-op owner receives a deed — a co-op owner receives stock and a proprietary lease, which are personal property.
- Thinking condo owners own the hallways and roof individually — those are common elements owned by all owners as tenants in common.
- Calling an assigned balcony or parking space a general common element — it is a limited common element.
- Assuming PUD owners own the common areas as tenants in common — the owners' association owns them.
- Calling a timeshare use real property — only a timeshare estate conveys a fee interest.
- Confusing the trust parties — the trustor creates the trust, the trustee holds legal title, and the beneficiary receives the benefit.

> **Make it a game · Deed or Stock?.** Make cards for CONDO, CO-OP, PUD, TIMESHARE ESTATE, TIMESHARE USE and TRUST. The caller reads a clue — "I got shares and a lease," "my assigned balcony belongs to everyone but only I may use it," "the association owns the pool," "one week a year, by deed," "the trustee holds my title." Players race to grab the matching card and shout REAL or PERSONAL. Correct card and category earns two points; correct card only earns one. Lightning round: the caller names an owner — corporation, limited partner, LLC member — and players must say how that owner holds title or what it risks.

> **Scripture.** “For which of you, intending to build a tower, sitteth not down first, and counteth the cost, whether he have sufficient to finish it?” (Luke 14:28, KJV)
>
> Shared ownership brings shared costs: assessments, reserves, a blanket mortgage, a roof that will someday need replacing. The Lord’s builder counts the whole cost before laying a stone. A wise buyer of a condominium, co-op or timeshare reads the budget and the reserve study first, so that no one is left unable to finish what was begun.

2.5 Liens, Easements and Encroachments

OBJECTIVES

- Define an encumbrance and classify encumbrances as financial (liens) or physical (easements, encroachments, restrictions).
- Classify liens as voluntary or involuntary, general or specific, and statutory or equitable, and rank lien priority, including the special priority of property taxes and special assessments.
- Explain mortgage, mechanics', judgment and tax liens, lis pendens and attachment.
- Distinguish easements appurtenant from easements in gross, describe easements by necessity, prescription, grant, reservation and party walls, and list the ways easements end.
- Distinguish an easement from a license and a profit, and explain how an encroachment is discovered and why it matters.

> **Warm-up.** Your neighbor's family has walked across a corner of your yard to reach the bus stop every day for twenty years, and you never minded. In five minutes, write whether you think they now have a legal right to keep doing it — and whether the answer should change if you had given them permission at the start.

WATCH

Basics of Easements & Encroachments | Real Estate Exam Prep Videos

The Real Estate Classroom · 10:36

https://www.youtube.com/watch?v=HsA2g1n57AY

> **WHEN TO WATCH**
> Watch after the easement paragraphs; copy his whiteboard drawing of the dominant and servient parcels into your notebook and label which one is benefited and which is burdened.

BACKUP VIDEO

liens - Pass your Real Estate Exam!

PrepAgent · 2:20

https://www.youtube.com/watch?v=dccNDC1WYF4

Watch with the lien paragraphs, since the main video covers easements; pause after each lien type and say aloud whether it is specific or general.

KEY TERMS

encumbrance

Any claim, lien, charge or limitation on real property that may lessen its value or restrict its use but does not prevent transfer of title.

lien

A financial encumbrance — a charge against property that makes it security for the payment of a debt or obligation.

specific lien

A lien against one particular property, such as a mortgage, property tax lien, special assessment or mechanic's lien.

general lien

A lien against all of a debtor's property in a county or state, such as a judgment lien or a federal income tax lien.

mechanic's lien

A specific, involuntary, statutory lien that secures payment to people who supplied labor or materials to improve real property; also called a construction lien.

lis pendens

A recorded notice that a lawsuit affecting title to or possession of a property is pending, warning anyone who acquires an interest that it is subject to the outcome.

easement

A nonpossessory right to use another's land for a particular purpose, such as access or utilities.

easement appurtenant

An easement that benefits a parcel of land (the dominant tenement) and burdens a neighboring parcel (the servient tenement); it runs with the land.

easement in gross

An easement that benefits a person or company rather than a parcel of land, such as a utility company's right to run lines; there is no dominant tenement.

easement by prescription

An easement acquired by use that is open, notorious, continuous, hostile (without permission) and uninterrupted for the period set by state law.

license

Personal, revocable permission to enter or use another's land, which is not an interest in land and ends at the death of either party or the sale of the land.

encroachment

An improvement — a building, fence, driveway or overhang — that illegally extends onto another's property; it is revealed by a survey.

CORE IDEAS

The story. In 1791 the United States had chosen the site for its new capital on the Potomac, and three commissioners appointed by President Washington were charged with building a city where there were mostly fields and woods. They needed master builders, and builders were wary of working on credit for owners who might not pay. In September 1791 the commissioners met at Georgetown with Secretary of State Thomas Jefferson and Congressman James Madison, and out of that meeting came a request to the Maryland General Assembly, which governed the land in the

federal district. The legislature acted before the year was out. Its new law gave master builders a lien on the houses they built and the land under them, so that a builder who was not paid could have the property sold to satisfy the debt. It was the first **mechanic's lien** law in America. Pennsylvania passed one in 1803, and the idea spread until every state had one. Today every plumber, roofer and lumberyard that improves a house enjoys the same protection.

How they figured it out. The common law had no mechanic's lien; it was created entirely by statute, which is why it is called a **statutory lien**. The law had, however, been working on the broader problem for centuries: how can a person hold a right in land that he does not own? Some rights secure money; others give a use — to cross a neighbor's field, to run a water line under it, to share a wall with it. English courts recognized such "incorporeal" rights early, and they learned that some could be created without any writing at all, by long use, just as a road worn across a common for generations became a right of way. Over time the law sorted all of these rights into one family called **encumbrances** — claims on land that do not take away ownership but burden it — and gave buyers a way to discover them: the public records for most liens and recorded easements, and a survey and an inspection of the ground for the rest.

The big idea. An **encumbrance** is any claim, lien, charge or limitation on real property that may reduce its value or restrict its use but does not prevent the owner from transferring title. Encumbrances fall into two groups. **Financial encumbrances** are **liens**, which make the property security for a debt. **Physical encumbrances** affect the use or condition of the land: easements, encroachments and deed restrictions (Unit 3). Every lien can be classified three ways. **Voluntary or involuntary**: a mortgage is voluntary, because the owner signs it; tax liens, judgment liens and mechanics' liens are involuntary. **Specific or general**: a **specific lien** attaches to one property — mortgages, property taxes, special assessments, mechanics' liens; a **general lien** attaches to all of a debtor's property in a county or state — judgment liens, federal income tax liens, estate and inheritance tax liens. **Statutory or equitable**: a statutory lien is created by law (a tax lien, a mechanic's lien); an equitable lien arises from fairness, by court decree.

When a property is sold or foreclosed and there is not enough money for everyone, **lien priority** decides who is paid first. The general rule is first in time, first in right, measured by the date and time of **recording**. The great exception is that **real**

property taxes and special assessments take priority over all other liens, regardless of when they arose. Mechanics' liens are a second, state-by-state exception: in many states a properly filed mechanic's lien relates back to the date work began or materials were first delivered, so it can outrank a mortgage recorded after construction started. A lender can also agree to move behind another by signing a **subordination agreement**. A **judgment lien** arises when a court's money judgment is recorded, attaching to all the debtor's real property in the county; a **mechanic's lien** must be filed within a deadline set by state law after the work is finished, or it is lost. Two more tools appear in lawsuits. A **lis pendens** ("suit pending") is a recorded notice that a lawsuit affecting the title is underway; anyone who buys or lends afterward takes subject to the outcome. A **writ of attachment** is a court order that holds a defendant's property as security for a possible judgment, so it cannot be sold while the case is pending.

An **easement** is a right to use another's land for a particular purpose without possessing it. An **easement appurtenant** involves two parcels: the **dominant tenement**, which benefits, and the **servient tenement**, which is burdened — a driveway across the front lot serving the back lot, for example. It **runs with the land**: when either parcel is sold, the benefit or burden passes automatically. An **easement in gross** benefits a person or company rather than a parcel; there is no dominant tenement. Utility easements are the common example; commercial ones can be assigned. An **easement by grant** is created in a deed or written agreement; an **easement by reservation** is kept by a seller in the deed conveying the land. An **easement by necessity** arises when an owner divides land and leaves a parcel landlocked; the law grants access over the land it was divided from, only while the necessity lasts. An **easement by prescription** is acquired by use that is **open, notorious, continuous, hostile** (without permission) and uninterrupted for the period set by state law — commonly ten to twenty years. Successive users may add their periods together (**tacking**); prescription is the cousin of adverse possession (Lesson 6.3). A **party wall** is a shared wall on a boundary line; each owner commonly owns his half with an easement of support in the other.

Easements can end. They end by **merger**, when one person comes to own both the dominant and servient parcels; by **release**, when the dominant owner gives up the easement in writing, often by quitclaim deed; by **abandonment** (intent plus non-use); when the **necessity ends** (a new public road reaches the landlocked lot); when

its **purpose ends**; by **condemnation**; or at the end of a stated term. An easement is different from a **license**, which is personal, revocable permission to use land — a ticket to a game, permission to fish in a neighbor's pond. A license is not an interest in land; it can be revoked at any time and ends at the death of either party or the sale of the land. So permission defeats prescription. A **profit** (profit à prendre) is the right to take something from another's land — timber, gravel, fish. Finally, an **encroachment** is an improvement that extends illegally onto someone else's land: a garage two feet over the line, a fence in the wrong place. A **survey**, not a title search, discovers them; left unchallenged, they may ripen into a prescriptive easement or even title by adverse possession.

On the exam today. Expect four or five questions, one of the larger clusters in Property Ownership. Classify liens on three axes: voluntary/involuntary, specific/general, statutory/equitable. The priority trap: property taxes and special assessments come first regardless of recording date; otherwise first recorded, first paid. Easement traps: appurtenant needs two parcels (dominant benefits, servient burdened) and runs with the land; in gross has no dominant tenement; necessity requires a landlocked parcel once part of the same tract and ends when the need ends; prescription requires open, notorious, continuous, hostile use for the statutory period — and permission defeats it. "A license is revocable, an easement is not" is the classic distinction. Watch also for "a judgment lien is specific" (general), "a mortgage is involuntary" (voluntary), "a title search reveals encroachments" (a survey does), and "merger" as the way an easement ends when one owner acquires both parcels.

PICTURE STUDY



The Courtyard of a House in Delft, Pieter de Hooch, 1658 · Oil on canvas · The National Gallery, London

Image: Wikimedia Commons, public domain

Pieter de Hooch (1629–1684) worked in Delft in the same years as Vermeer and became the great painter of Dutch courtyards and passageways — the in-between spaces where one household's property meets another's and the street. In this painting of 1658, a long passage runs from the sunny back courtyard straight through the house to the street, and a wooden shed leans against the neighbor's brick wall. It opens this lesson because nearly every physical encumbrance is here: a passage someone may need to cross, a wall shared at a boundary, a structure built right up to the line.

Look closely

- Follow the arched passage from the courtyard to the street. If a family living behind this house had the right to walk through it to reach the street, which property would be dominant and which servient?
- Look at the wooden lean-to and trellis on the right, built against the brick wall. If that wall stood on the boundary, whose wall would it be — and could the shed cross the line?
- Find the carved stone tablet above the arch, dated 1614. Old stones set in walls were often reused from other buildings; they also served as markers that neighbors recognized for generations.

- Notice the bucket, the broom and the swept paving. The courtyard is a working space, and work requires access — to water, to the street, to the neighbors.

Talk about it

1. If the neighbor behind this house had used the passage to the street openly and without permission for longer than the period set by law, what right might he have gained? What one fact would have prevented it?
2. If the lean-to on the right extended a foot onto the neighbor's land, what would it be called, and how would a buyer discover it?
3. De Hooch painted households living wall to wall, depending on one another's passages and walls. Scripture forbids a lender to march into a debtor's house to seize his pledge. What does that rule teach about respecting a neighbor's home even when you hold a claim against him?

PROJECT

The Encumbrance Report

Before every closing, someone must answer a simple question: what claims and rights burden this property? In this project you will write the encumbrance report for a pretend property, rank its liens for a pretend foreclosure, and map its easements — then find a real recorded easement or lien type in your county's records to see what the documents look like.

You will need

- Graph paper, ruler and colored pencils
- Free spreadsheet software or ruled paper
- Your county recorder's or auditor's website (free and public)
- This lesson's worked examples

Steps

1. Invent a pretend property, "14 Orchard Lane," and give it these encumbrances: a first mortgage recorded in 2018, a second mortgage recorded in 2022, unpaid property taxes, a recorded judgment lien from 2023, a roofer's mechanic's lien, a utility easement along the back lot line, a driveway easement benefiting the lot behind, and a neighbor's fence two feet over the side line.
2. Classify each lien three ways (voluntary or involuntary, specific or general, statutory or equitable) in a table.
3. Rank the liens for a pretend foreclosure sale that brings $300,000, with pretend balances you choose; show who is paid in full, who is paid in part and who gets nothing. Add a note that a mechanic's lien's priority depends on state law.
4. Draw the lot to scale with the lot behind it. Mark the dominant and servient tenements, the easement in gross, and the encroaching fence in different colors.
5. Write two paragraphs: how each easement could end, and how the fence was discovered (by survey) and what the owner's options are.

6. On your county recorder's site, find the list of recordable document types and note the names your county uses for a lien release, an easement and a lis pendens. Copy no private information.
7. Title the report "Encumbrance Report — 14 Orchard Lane," date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Flashcards for every key term; make a lien-classification card with three axes — voluntary/involuntary, specific/general, statutory/equitable — and two examples on each axis.
2. Draw two lots side by side with a driveway crossing the front lot to the back lot; label DOMINANT (benefited) and SERVIENT (burdened), and beside it draw a utility line labeled IN GROSS — NO DOMINANT TENEMENT.
3. Write a trap list titled "Encumbrances": taxes and special assessments first; judgment liens are general; prescription = open, notorious, continuous, hostile, statutory period; permission defeats prescription; a license is revocable, an easement is not; merger ends an easement; a survey finds encroachments.

> **From history.** English law developed a famous prescriptive right called "ancient lights." If a window had received daylight across a neighbor's land for a long period, the owner could stop the neighbor from building in a way that blocked it. Parliament's Prescription Act of 1832 fixed the period at twenty years, and small signs reading "Ancient Lights" can still be seen on old London buildings. American courts mostly refused to adopt the doctrine, holding that a growing country could not let a window freeze the use of the land next door.

Example 1. Exam style. A property sells at a foreclosure sale. The following liens exist: a mortgage recorded March 2019, a judgment lien recorded June 2021, and unpaid current property taxes. Which is paid FIRST?

A. The mortgage, because it was recorded first

B. The judgment lien, because it is a general lien

C. The property taxes, regardless of when they arose

D. All three share equally

Show solution

1. Start with the rule: liens are generally paid in order of recording.
2. Apply the exception: real property taxes and special assessments take priority over all other liens.
3. So the taxes are paid first, then the 2019 mortgage, then the 2021 judgment lien, as far as the money goes.
4. B confuses general with senior; A ignores the tax exception.

Answer: C. Property taxes come first regardless of recording date; then the mortgage, then the judgment.

Example 2. Classify each lien three ways (voluntary/involuntary, specific/general, statutory/equitable): (1) a home mortgage; (2) a roofer's unpaid-bill lien on the house he reroofed; (3) a recorded court judgment against the owner for a car accident.

Show solution

1. Mortgage: the owner signed it (voluntary), it covers one property (specific), and it is created by agreement rather than statute — usually just called a voluntary, specific lien.
2. Roofer's lien: a mechanic's lien — involuntary, specific to the improved property, statutory.
3. Judgment lien: involuntary; once recorded, it attaches to all the debtor's real property in the county (general); it arises from a court judgment under statute.
4. Remember: "specific" always means one property; "general" means everything the debtor owns in the area.

Answer: (1) Voluntary, specific; (2) involuntary, specific, statutory; (3) involuntary, general (by statute upon recording).

Example 3. Lot A fronts the county road; Lot B lies behind it. Twenty-five years ago, the owner of both sold Lot B and recorded a driveway easement across Lot A for Lot B's benefit. Lot A has since been sold twice, and the owner of Lot B has just bought Lot A as well. Analyze the easement through each event.

Show solution

1. Creation: an easement by grant (recorded in the deed), appurtenant, because it benefits a parcel. Lot B is the dominant tenement; Lot A is the servient tenement.
2. Sales of Lot A: an easement appurtenant runs with the land, so each new owner of Lot A took subject to the driveway.
3. Purchase of Lot A by Lot B's owner: one person now owns both the dominant and servient tenements.
4. A person cannot hold an easement over his own land, so the easement ends by merger. If the lots are later sold separately, a new easement would have to be created.

Answer: An appurtenant easement by grant that ran with the land through each sale and has now ended by merger.

PRACTICE

1. Easy What is the difference between a specific lien and a general lien?

   Show answer

   A specific lien attaches to one particular property (a mortgage, property tax lien, mechanic's lien); a general lien attaches to all of a debtor's property in the county or state (a judgment lien, federal income tax lien).

2. Easy Which liens take priority over all others regardless of when they were recorded?

   Show answer

   Real property taxes and special assessments.

3. Easy In an easement appurtenant, which parcel is the dominant tenement?

Show answer

The parcel that benefits from the easement; the servient tenement is the parcel burdened by it.

4. Medium Is a mortgage a voluntary or involuntary lien? Specific or general?

Show answer

Voluntary, because the owner chose to sign it; specific, because it attaches to one property.

5. Medium A power company holds the right to run lines across the back of a subdivision. What kind of easement is this, and why?

Show answer

An easement in gross, because it benefits a company rather than a neighboring parcel; there is no dominant tenement.

6. Medium List the elements of an easement by prescription.

Show answer

Use that is open, notorious, continuous, hostile (without permission) and uninterrupted for the period set by state law, commonly ten to twenty years.

7. Medium A homeowner lets a neighbor fish in her pond "anytime." She later sells the house. May the neighbor keep fishing?

Show answer

No. The permission was a license — personal and revocable — which ends when the land is sold (or at either party's death) and was never an interest in land.

8. Hard A seller divides his farm and sells the back 40 acres, which have no road access except across the front parcel he keeps. The deed says nothing about access. What right does the buyer have, and when would it end?

Show answer

An easement by necessity across the seller's remaining land, because the parcel is landlocked and was once part of the same tract. It ends when the necessity ends — for example, if a public road is built to the back parcel.

9. Hard A buyer discovers a recorded lis pendens on a house she wants to buy. What does it mean, and what is the risk?

Show answer

A lis pendens is recorded notice that a lawsuit affecting the property's title or possession is pending. Anyone who buys afterward takes subject to the outcome, so the buyer could lose the property or face claims if the plaintiff wins.

10. Hard A foreclosure sale nets $250,000. Liens: property taxes $6,000; first mortgage (recorded 2017) $210,000; second mortgage (recorded 2020) $50,000. In this example, how much does each receive?

Show answer

Taxes first: $6,000, leaving $244,000. First mortgage: $210,000, leaving $34,000. Second mortgage receives the remaining $34,000 of its $50,000 and is short $16,000.

11. Challenge Explain why a neighbor's twenty years of crossing a yard with the owner's permission never ripens into an easement by prescription, while the same twenty years without permission might.

Show answer

Prescription requires hostile use — use without the owner's permission, as if by right. Permitted use is a license, which is consistent with the owner's ownership, so no matter how long it lasts it never becomes hostile. Without permission, open and continuous use for the statutory period can create a prescriptive easement.

12. Challenge Why did the Maryland legislature of 1791 give builders a lien instead of simply letting them sue owners who did not pay?

Show answer

A lawsuit gives only a personal claim against an owner who may have no money; a lien makes the improved property itself security for the debt, so the builder can have it sold to be paid. The lien encouraged builders to work in the new federal city by assuring them that the houses they built would stand behind their bills.

COMMON MISTAKES

- Calling a judgment lien specific — once recorded, it is a general lien on all the debtor's real property in the county.
- Ranking liens strictly by recording date — real property taxes and special assessments come first regardless of date.
- Thinking an easement in gross has a dominant tenement — it benefits a person or company, not a parcel.
- Forgetting that permission defeats prescription — prescriptive use must be hostile.
- Confusing a license with an easement — a license is personal and revocable and ends at death or sale; an easement is an interest in land.
- Expecting a title search to reveal an encroachment — encroachments are found by a survey.

Make it a game · Easement, License or Lien?. Make three big cards: EASEMENT, LICENSE, LIEN. The caller reads scenes — "the gas company's pipe under your yard," "your aunt lets you park in her driveway this weekend," "the roofer was never paid," "a driveway to the back lot that every owner has used since 1950," "a court judgment for $8,000 is recorded." Players race to slap the right card, then must add one more word: APPURTENANT or IN GROSS for easements, REVOCABLE for licenses, SPECIFIC or GENERAL for liens. Two points for both words, one for the card alone. Final round: rank three liens for a foreclosure — the first to shout "TAXES FIRST!" wins a bonus.

Scripture. "When thou dost lend thy brother any thing, thou shalt not go into his house to fetch his pledge. Thou shalt stand abroad, and the man to whom thou dost lend shall bring out the pledge abroad unto thee." (Deuteronomy 24:10–11, KJV)

A lien is a pledge: property that stands behind a debt. The law of Moses let the lender hold a pledge but forbade him to barge into the debtor's home to seize it. Modern lien law likewise protects both sides — the lender's right to be paid and the owner's right to an orderly process — and a licensee should honor both.

UNIT 2

Ownership, Estates and Encumbrances

Unit 1 asked what land is and where it lies. This unit asks the harder question: what, exactly, does an owner own? You will begin with William the Conqueror's commissioners riding from village to village in 1086, and follow the law as it turned feudal holdings into the **estates** you will meet on every exam — the **fee simple absolute**, the defeasible fees with their "so long as" and "but if," and the **life estate** with its remainders and reversions. You will learn what a tenant owns, from the **estate for years** to the holdover **estate at sufferance**, through the story of the old Elgin Garden land in Manhattan, leased in 1928 to the builder of Rockefeller Center.

Then you will see how people own together — in **severalty**, as **tenants in common**, as **joint tenants** with the right of survivorship, and under the **community property** law of Washington and Idaho — and how they own apartments, shares, weeks and trusts. The unit ends with the claims that burden every title: **liens**, from the first mechanic's lien passed for the builders of Washington, D.C., in 1791 to the judgment and tax liens of today; **easements** that let a neighbor cross; and the **encroachments** only a survey can find. Property Ownership is about a tenth of the national exam, and its vocabulary returns in contracts, title and closing — learn it well now.

PREREQUISITES

- Can explain the bundle of rights and name its five rights, from Lesson 1.2
- Can distinguish real property from personal property and define a fixture, from Lesson 1.1
- Can explain why a survey reveals what a title search cannot, from Lesson 1.3
- Has the exam notebook and index-card deck current through Unit 1, with every missed unit-test question corrected

MASTERY CHECKLIST

- ☐ I can define fee simple absolute and tell a fee simple determinable ("so long as," possibility of reverter) from a condition subsequent ("but if," right of re-entry).
- ☐ I can distinguish ordinary and pur autre vie life estates, remainder from reversion, and state a life tenant's rights and duty not to commit waste.
- ☐ I can classify the four leasehold estates and say how each ends, including what happens at a party's death or the sale of the property.
- ☐ I can compare severalty, tenancy in common, joint tenancy (PITT) and tenancy by the entirety, and trace title through a sale or death.
- ☐ I can distinguish community from separate property and name the Northwest's community property states.
- ☐ I can contrast condominiums, cooperatives, PUDs and timeshares, name the parties to a trust, and explain how business entities hold title.
- ☐ I can classify liens three ways and rank lien priority, including the priority of property taxes and special assessments.
- ☐ I can distinguish easements appurtenant and in gross, explain easements by necessity and

prescription, list how easements end, and tell an easement from a license and an encroachment.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Blackstone's Commentaries on the Laws of England (The Avalon Project, Yale Law School)**: Free. The full text of the 1760s treatise that taught American lawyers the law of estates; Book II, chapters 7 through 10, covers freeholds, life estates, estates less than freehold and co-ownership. Dip into it with Lessons 2.1 through 2.3 to read the old definitions in the original. Ages 15 and up.
- **IRS Publication 555: Community Property**: Free, official. The Internal Revenue Service's explanation of community and separate property, with the list of community property states. Read the first sections with Lesson 2.3. Ages 15 and up.
- **Revised Code of Washington, Chapter 26.16 (separate and community property)**: Free, official. Washington's own statute defining separate and community property and the rules for conveying community real property — a model of how a community property state writes the law. Read sections 26.16.010 through 26.16.030 with Lesson 2.3. Ages 16 and up.
- **HUD: Tenant Rights, Laws and Protections**: Free, official. The Department of Housing and Urban Development's gateway to tenant rights, with links to each state's landlord-tenant resources. Use it in Lesson 2.2's project to find your state's official notice rules. Ages 14 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

2.1	**The Bundle of Rights and the Freehold Estates**	3 sessions of 50 minutes
2.2	**Leasehold Estates: What a Tenant Owns**	3 sessions of 50 minutes
2.3	**Owning Together: Severalty, Tenancy in Common and Joint Tenancy**	3 sessions of 50 minutes
2.4	**Condominiums, Cooperatives, Timeshares and Trusts**	3 sessions of 50 minutes

Unit 2 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions in the style of the national exam, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. A score of 70% (14 of 20) matches the common passing line, but aim higher. Figures marked "in this example" are examples. Choose the one BEST answer.

1. **5 pts**

   The most complete form of ownership recognized by law — unlimited in duration, freely transferable and inheritable — is:

   A. Fee simple absolute

   B. Fee simple determinable

   C. A life estate

   D. An estate for years

2. **5 pts**

   A grantor conveys land "to the county so long as it is used as a public park." Ten years later the county builds a parking garage on it. Which is TRUE?

   A. The grantor must sue to recover the land

   B. The land reverts automatically to the grantor or the grantor's heirs

   C. The county keeps the land, because the deed was a fee simple absolute

   D. The land escheats to the state

3. **5 pts**

   A deed reads "to Grace for life, then to Henry." Henry's interest is BEST described as:

   A. A reversion

   B. A leasehold

   C. A remainder

   D. A possibility of reverter

4. 5 pts

Owen holds a life estate in a farm “for the life of his grandmother, Ida.” Owen dies, survived by his son; Ida is still living. Which is TRUE?

A. The life estate ends at Owen’s death

B. The farm reverts to the grantor immediately

C. Ida now owns the farm in fee simple

D. Owen’s son holds the life estate until Ida dies

5. 5 pts

Which of the following may a life tenant NOT do without the consent of the remainderman?

A. Rent the property to a tenant

B. Cut and sell all the mature timber, greatly reducing the land’s value

C. Sell her life estate to a buyer

D. Live on the property

6. 5 pts

A tenant signs a lease from September 1 through May 31 for an apartment near a college. Which statement is correct?

A. It is an estate for years, and it ends on May 31 without notice from either party

B. It is a periodic tenancy, because it is shorter than one year

C. It is an estate at will, because no renewal is stated

D. The tenant must give 30 days’ notice to end it on May 31

7. 5 pts

A tenant’s lease expired last week. She remains in the apartment, and the landlord has neither consented nor accepted rent. She holds:

A. An estate for years

B. A periodic estate

C. An estate at will

D. An estate at sufferance

8. 5 pts

Which leasehold estate is ended by the death of either the landlord or the tenant?

A. Estate for years

B. Periodic estate

C. Estate at will

D. Leased fee

9. 5 pts

An investor buys a rental house occupied by a tenant who has eight months left on a written lease. The investor:

A. Must evict the tenant within 30 days of closing

B. May cancel the lease because a sale ends all leases

C. Takes title subject to the lease and must honor it for its remaining term

D. May raise the rent immediately to any amount

10. 5 pts

Ava, Ben and Cole own land as joint tenants. Ava conveys her interest to Dana. Then Ben dies, leaving a will that gives everything to his daughter. The land is now owned by:

A. Cole (two-thirds) and Dana (one-third) as tenants in common

B. Cole and Dana as joint tenants, one-half each

C. Cole, Dana and Ben's daughter, one-third each, as tenants in common

D. Cole alone, in severalty

11. 5 pts

All of the following are among the four unities required for a joint tenancy EXCEPT:

A. Possession

B. Interest

C. Time

D. Use

12. 5 pts

A corporation buys a warehouse in its own name. The corporation holds title:

A. As a joint tenant with its shareholders

B. In severalty

C. As a tenant in common with its officers

D. By the entirety

13. 5 pts

A married couple lives in Idaho. During the marriage, the wife inherits a rental house from her uncle. Under community property law, the rental house is:

A. Community property, because it was acquired during the marriage

B. Owned by the couple as joint tenants

C. Owned by the couple as tenants by the entirety

D. The wife's separate property

14. 5 pts

A buyer of a cooperative apartment receives:

A. A deed to the unit and an undivided interest in the common elements

B. A fee simple interest for one week each year

C. Shares of stock in the corporation and a proprietary lease

D. A leasehold estate from the condominium association

15. 5 pts

A condominium declaration gives Unit 7 a 4% interest in the common elements, in this example. The association levies a $250,000 special assessment to repair the parking garage. Unit 7's share is:

A. $10,000

B. $4,000

C. $6,250

D. $25,000

16. 5 pts

In a trust holding real estate, legal title is held by the:

A. Trustor

B. Trustee

C. Beneficiary

D. Settlor’s heirs

17. 5 pts

A foreclosure sale nets $200,000, in this example. The property is subject to unpaid property taxes of $5,000, a first mortgage recorded in 2018 with a balance of $170,000, and a judgment lien recorded in 2022 for $40,000. How much does the judgment creditor receive?

A. $40,000

B. $25,000

C. $30,000

D. Nothing

18. 5 pts

A court judgment for $15,000 is recorded against a homeowner in his county. The resulting lien is:

A. Voluntary and specific

B. Voluntary and general

C. Involuntary and specific

D. Involuntary and general

19. 5 pts

Lot 2 has a recorded right to use a driveway across Lot 1 to reach the road. Lot 1 is sold to a new owner. Which is TRUE?

A. The easement is appurtenant; it runs with the land, and the new owner of Lot 1 takes subject to it

B. The easement is in gross and ends at the sale

C. The easement was a license and is revoked by the sale

D. Lot 1 is the dominant tenement

20. 5 pts

For twenty years, with the owner’s friendly permission, a neighbor has crossed a corner of the owner’s lot to reach a lake. The statutory prescriptive period in this example is ten years. The neighbor holds:

A. An easement by prescription

B. An easement by necessity

C. A revocable license

D. An easement appurtenant by grant

ANSWER KEY

1. A. Fee simple absolute is the highest estate. A determinable fee can end if its condition is broken, a life estate ends at a death, and an estate for years is a leasehold, not ownership.
2. B. "So long as" creates a fee simple determinable, which ends automatically when the use stops; the grantor's possibility of reverter takes effect without a lawsuit. A describes a condition subsequent ("but if"), where the grantor holds a right of re-entry.
3. C. A third party named to take after a life estate holds a remainder and is the remainderman. A reversion (A) would return the property to the grantor or the grantor's heirs.
4. D. A life estate pur autre vie is measured by another person's life — here Ida's — so it continues after Owen's death and passes to his heirs until Ida dies. A applies to an ordinary life estate measured by the tenant's own life.
5. B. Destroying a major part of the property's value is waste, which harms the remainderman. A life tenant may possess, lease and sell the life estate (A, C, D), though anything she conveys ends when the measuring life ends.
6. A. Any leasehold with a fixed beginning and end is an estate for years, whatever its length, and it ends automatically. B is the classic trap — "years" does not require a year or more.
7. D. A tenant who came into possession lawfully but stays after the lease ends without the landlord's consent is a holdover tenant holding an estate at sufferance. If the landlord accepted rent, a periodic tenancy would commonly arise.
8. C. An estate at will lasts only as long as both parties wish and ends at the death of either. An estate for years and a periodic estate generally bind the parties' heirs and estates; the leased fee (D) is the landlord's interest, not a leasehold.
9. C. Sale does not break the lease: the buyer steps into the landlord's position and takes subject to the tenant's right of possession for the rest of the term, on the lease's terms.
10. A. Ava's conveyance severed her third, so Dana became a tenant in common. Ben and Cole remained joint tenants, so at Ben's death his third passed to Cole by survivorship, defeating the will. Cole holds two-thirds and Dana one-third, as tenants in common.

11. D. The four unities are possession, interest, time and title (PITT). “Use” is not one of them; unity of possession already gives each owner the right to use the whole.
12. B. A corporation is a single legal person, so it owns in severalty — sole ownership. Its shareholders own stock, not the real estate, and a corporation generally cannot be a joint tenant.
13. D. Property acquired during marriage by gift or inheritance is separate property in community property states such as Idaho and Washington. A is the trap: most — but not all — property acquired during marriage is community property.
14. C. In a co-op the corporation owns the building, and the resident owns shares and a proprietary lease — personal property. A describes a condominium; B describes a timeshare estate.
15. A. $0.04 \times \$250{,}000 = \$10{,}000$. Assessments are shared by each unit’s percentage interest in the common elements unless the declaration provides otherwise.
16. B. The trustee holds legal title and manages the property for the beneficiary, who holds the equitable interest. The trustor (also called the settlor or grantor) creates the trust.
17. B. Property taxes are paid first regardless of date ($5,000, leaving $195,000); then the earlier-recorded mortgage ($170,000, leaving $25,000); the judgment creditor receives the remaining $25,000. C forgets the taxes.
18. D. A judgment lien is imposed without the owner’s consent (involuntary) and, once recorded, attaches to all the debtor’s real property in the county (general). A mortgage is the classic voluntary, specific lien.
19. A. An easement benefiting a neighboring parcel is appurtenant and runs with the land; Lot 2 is dominant and Lot 1 servient. Selling the servient parcel does not end it.
20. C. Use with permission is a license, which is revocable and never ripens into a prescriptive easement, because prescription requires hostile use. Necessity (B) requires a landlocked parcel; a grant (D) requires a written conveyance.

PORTFOLIO PIECE: MY PATHWAY FILE — THE OWNERSHIP PAGES

Assemble the ownership section of your Pathway File: the Estates Ladder with its five family deeds and timelines (2.1); the Four Tenancies casebook with your state's official notice rule, dated and sourced (2.2); the Owning Together decision tree with its six title scenarios and the vesting words from a real recorded deed (2.3); the Four Doors In comparison of condominium, co-op, PUD and timeshare, with its pretend budgets, special-assessment computation and chart of trusts and business owners (2.4); and the Encumbrance Report for 14 Orchard Lane, with its classified liens, foreclosure ranking and easement map (2.5).

Close the section with a one-page cover memo to a pretend first client — a family buying a condominium in Washington with their savings. In your own words, explain what they will own and what they will share, how community property affects who signs, what liens and easements the title report and survey may show, and why you will urge them to read the association's budget and to ask an attorney how to hold title. End with Luke 14:28 and one sentence on counting the cost. Date every page.

LOOK FOR	WHAT IT MEANS
Estates ladder and deeds	Every rung shows correct creating words, duration and future interest; the five family deeds use precise granting language; and each timeline names who holds the present and future interests.
Four Tenancies casebook	Each pretend tenant is correctly classified with how the tenancy ends and what happens at death and sale, and the state notice rule is quoted from an official source with the date checked.
Owning Together	The decision tree is accurate, all six title scenarios end with correct fractions and forms of ownership, and the real vesting words are correctly identified with no private names copied.
Four Doors In	The comparison correctly marks each form as real or personal property, the budgets use labeled example figures, the special assessment is computed correctly, and the trust and business-entity chart states how each holds title.
Encumbrance Report	All liens are classified on three axes, the foreclosure ranking puts property taxes first and pays the rest in recording order, and the easement map labels dominant, servient and in-gross easements and the encroachment.

LOOK FOR	WHAT IT MEANS
Cover memo	Written in the student's own voice, it explains condominium ownership and community property accurately, refers title-holding choices to an attorney, and ties the counting-the-cost verse to careful buying without canned language.

UNIT 3

Land Use, Taxes and the Environment

In 1926 a real estate company in a small Ohio village told the Supreme Court it had lost three-quarters of its land's value — not to a fire or a flood, but to a new law that said most of its acres could hold houses and not factories. The Supreme Court said the village was within its rights. This unit is about the limits that surround every parcel of private land, however firmly owned. You will begin with the four powers that every government holds over land — the **police power**, **eminent domain**, **taxation** and **escheat** — and learn exactly when the government must pay and when it need not. You will study **zoning** from *Euclid v. Ambler* to the **variance**, the **conditional use permit** and the **nonconforming use**, and the private rules neighbors make for one another through **deed restrictions**, **CC&Rs** and owners' associations.

Then you will follow the money and the ground itself. You will build a property tax from market value to **assessed value** to the bill, convert rates among **mills** and dollars per hundred, and apportion a **special assessment** by the front foot. Last, you will learn the hazards a buyer cannot see — lead-based paint, asbestos, radon, buried tanks, contaminated ground and the flood plain — and the federal laws, from **CERCLA** to the flood insurance program, that decide who must disclose, who must test and who must pay. Keep your calculator nearby for Lesson 3.4, and keep your conscience nearby throughout: most of this unit is about telling the truth about land.

PREREQUISITES

- Can explain fee simple ownership and the bundle of rights from Unit 2, and why even full ownership has limits
- Can tell a lien from an easement and a voluntary lien from an involuntary one (Lesson 2.5)
- Can compute percents, convert between decimals and percents, and find area in square feet and acres (43,560 square feet per acre)
- Has the exam notebook current, with the Unit 2 vocabulary of estates, encumbrances and recording ready for review

MASTERY CHECKLIST

- ☐ I can name the four powers of government (PETE), classify any government action under the right one, and say when compensation is owed.
- ☐ I can compute just compensation for a partial taking and separate it into the value of the part taken and severance damages.
- ☐ I can explain *Euclid v. Amb ler* and choose correctly among a variance, a conditional use permit, a nonconforming use, a rezoning and illegal spot zoning.
- ☐ I can compute a buildable footprint from setbacks and check lot coverage and floor-area ratio.
- ☐ I can distinguish deed restrictions from CC&Rs and a covenant from a condition, name the ways restrictions end, and apply the more-restrictive-governs rule.
- ☐ I can compute a property tax from market value, assessment ratio, exemptions and a rate in mills or per $100, and set a rate from a budget.
- ☐ I can apportion a special assessment and explain why tax and special-assessment liens take priority over an earlier mortgage.

- ☐ I can state the lead-based paint disclosure requirements, CERCLA's liability rules and the innocent landowner defense, and when flood insurance is required.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **EPA: Real Estate Disclosures About Potential Lead Hazards**: Free, official. The EPA's own page on the lead-based paint disclosure rule for sellers, landlords and agents, with the required pamphlet and sample disclosure forms. Use it with Lesson 3.5 and its project. Ages 15 and up.
- **EPA: Radon**: Free, official. What radon is, how homes are tested and fixed, the 4 pCi/L action level and a radon zone map by county. Read it with Lesson 3.5 and look up your own county. Ages 14 and up.
- **FEMA Flood Map Service Center**: Free, official. Search any address to see its flood zone on FEMA's Flood Insurance Rate Maps. Use it in the Lesson 3.5 project to tell a Zone AE from a Zone X. Ages 14 and up.
- **EPA: Search for Superfund Sites Where You Live**: Free, official. A map and search tool for Superfund sites by state and county, with each site's history and cleanup status. Use it with Lesson 3.5 to see CERCLA at work near home. Ages 15 and up.
- **Oyez: Village of Euclid v. Ambler Realty Co. (1926)**: Free. A plain summary of the zoning case, with the question presented and the holding, from a free academic project on the Supreme Court. Read it with Lesson 3.2 before the game. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

3.1 The Four Powers of Government — 3 sessions of 50 minutes

3.2 Zoning and Planning: Euclid v. Ambler — 3 sessions of 50 minutes

3.3 Private Controls: Deed Restrictions, CC&Rs and Owners' Associations
3 sessions of 50 minutes

3.4 Property Taxes and Special Assessments — 3 sessions of 50 minutes

Unit 3 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Seventy percent (14 of 20) matches the common passing line, but aim higher. Figures marked “in this example” are examples — real tax rates, assessment ratios and exemptions vary by state and county. Choose the one BEST answer.

1. **5 pts**

   A city adopts an ordinance dividing its land into residential, commercial and industrial districts. This is an exercise of:

   A. Eminent domain

   B. Police power

   C. Escheat

   D. Taxation

2. **5 pts**

   When a government takes private property by eminent domain, just compensation is measured by:

   A. The price the owner originally paid

   B. The property’s assessed value for taxes

   C. The property’s fair market value at the time of the taking

   D. The cost to rebuild the improvements new

3. **5 pts**

   Property escheats to the state when its owner dies:

   A. Without a will and without any heirs

   B. Without a will, leaving only distant cousins

   C. With a will leaving everything to a charity

   D. Owing more in property taxes than the land is worth

4. 5 pts

In this example, a ranch is worth $600,000 before the state takes a strip for a highway. The strip itself is worth $80,000, and the remaining land is worth $470,000 after the taking. What are the severance damages?

A. $130,000

B. $80,000

C. $50,000

D. $470,000

5. 5 pts

An owner's lot is so narrow and steep that no house can meet the required side setbacks. The owner should apply for a:

A. Rezoning

B. Variance

C. Conditional use permit

D. Nonconforming use

6. 5 pts

A small grocery has operated on a corner since 1955. In 1980 the neighborhood was zoned single-family residential. The grocery may continue as a(n):

A. Variance

B. Spot zoning

C. Conditional use

D. Nonconforming use

7. 5 pts

Spot zoning is BEST described as:

A. Rezoning a single parcel inconsistently with the comprehensive plan, for the benefit of its owner

B. Granting a variance for a hardship unique to one lot

C. Approving a church in a residential district

D. Mapping a flood hazard area on one parcel

8. 5 pts

The zoning for a subdivision permits duplexes. The subdivision's recorded CC&Rs allow only single-family homes. An owner wants to build a duplex. Which is correct?

A. The duplex is allowed because zoning is public law and overrides private agreements

B. Only a single-family home may be built because the more restrictive rule governs

C. The owner may choose whichever rule he prefers

D. The city must enforce the CC&Rs before the owner can build

9. 5 pts

A neighbor violates a restrictive covenant in the subdivision declaration by building a fence twice the allowed height. The usual remedy for the other owners is:

A. Forfeiture of the neighbor's title

B. Condemnation of the fence

C. Escheat of the lot to the association

D. An injunction ordering the fence removed or lowered

10. 5 pts

For ten years the owners in a subdivision ignored a neighbor's workshop that violated the CC&Rs while he expanded it at great expense. When they finally sue, he argues they waited too long. His defense is:

A. Merger

B. Escheat

C. Laches

D. Abandonment of the easement

11. 5 pts

An owner stops paying the dues and special assessments of his homeowners' association. Under the typical declaration and state law, the unpaid amounts:

A. Become a lien on his lot

B. Are forgiven after one year

C. Must be paid by the other owners

D. Are collected by the county assessor

12. 5 pts

In this example, a home has a market value of $300,000. The state assesses property at 80% of market value, the owner has no exemptions, and the tax rate is 25 mills. What is the annual tax?

A. $7,500

B. $6,000

C. $600

D. $60,000

13. 5 pts

In this example, a school district must raise $3,000,000 in property taxes from a district whose total taxable value is $200,000,000. What tax rate must it levy?

A. 1.5 mills

B. 0.15 mills

C. 15 mills

D. 150 mills

14. 5 pts

Which statement about a special assessment is correct?

A. It is an ad valorem tax paid by every property owner in the county

B. It is a voluntary lien the owner signs to pay for improvements

C. It is charged only when a property is sold

D. It is charged to the properties that benefit from a specific public improvement

15. 5 pts

A mortgage on a house was recorded in 2018. In 2025 the owner fails to pay real property taxes. Which lien has priority?

A. The real property tax lien

B. The mortgage, because it was recorded first

C. Whichever lienholder forecloses first

D. Neither; they share equally

16. 5 pts

Under the federal lead-based paint disclosure rule for the sale of a house built in 1965, all of the following are required EXCEPT:

A. Giving the buyer the EPA lead hazard pamphlet

B. Including the Lead Warning Statement in the contract

C. Offering the buyer a 10-day opportunity to test for lead

D. Removing all lead-based paint before closing

17. 5 pts

Radon is BEST described as:

A. A fibrous mineral used in older insulation

B. A chemical once added to house paint

C. A colorless, odorless radioactive gas from the natural decay of uranium in soil

D. A mold that grows behind damp walls

18. 5 pts

Under CERCLA, liability for cleaning up a contaminated site is:

A. Strict, joint and several, and retroactive

B. Limited to the party that actually dumped the waste

C. Avoided by any owner who buys the land “as is”

D. Limited to the purchase price the current owner paid

19. 5 pts

A buyer of a former industrial site wants to qualify for the innocent landowner defense. She should, before closing:

A. Ask the seller to sign an “as is” clause

B. Obtain a Phase I environmental site assessment showing all appropriate inquiry

C. Record a deed restriction against future dumping

D. Purchase a standard homeowners policy

20. 5 pts

A buyer is financing a home with a VA-guaranteed loan. FEMA maps the home in Zone VE on the coast. Which is true?

A. Flood insurance is optional because the homeowners policy covers flood

B. Flood insurance is required only if the home flooded in the last ten years

C. Flood insurance is never required on VA loans

D. Flood insurance is required because the home is in a special flood hazard area and the loan is federally backed

ANSWER KEY

1. B. Zoning regulates the use of land for health, safety and general welfare — the police power — and ordinarily requires no compensation. A is the classic trap: eminent domain takes title and must pay.
2. C. Just compensation is fair market value at the time of the taking. Assessed value may differ from market value, and the owner's original price is irrelevant.
3. A. Escheat requires both no will and no heirs who can inherit. Distant relatives usually inherit under intestacy statutes, and a will to a charity controls; unpaid taxes lead to a tax sale, not escheat.
4. C. Total just compensation is value before minus value after: $600,000 − $470,000 = $130,000. Of that, $80,000 pays for the strip, so severance damages — the loss in value of the remainder — are $50,000. A is the total award, not the severance damages.
5. B. A variance grants relief from a dimensional requirement when the property's unique conditions cause unnecessary hardship. A conditional use permit concerns a use, and a rezoning changes the district.
6. D. A use that was lawful before the zoning changed may continue as a legal nonconforming ("grandfathered") use, though it generally may not expand, and abandonment can end it.
7. A. Spot zoning singles out one parcel for treatment inconsistent with the plan and the surrounding area, and courts generally hold it illegal. B describes a lawful variance.
8. B. When public and private restrictions conflict, the more restrictive generally governs. Zoning does not override a stricter recorded covenant, and the CC&Rs are enforced by the association and owners, not the city.
9. D. A covenant is enforced by injunction or damages. Forfeiture of title is the remedy for breach of a condition, not a covenant.
10. C. Laches bars enforcement when a party unreasonably delays and the delay harms the other side. Merger ends a covenant when one owner acquires both benefited and burdened land.
11. A. Unpaid association assessments become a lien on the owner's lot, which in many states the association may foreclose. That is why buyers check association status before closing.
12. B. Assessed value is $300,000 × 0.80 = $240,000. Twenty-five mills is 0.025, so the tax is $240,000 × 0.025 = $6,000. A applies the rate to market value instead of

assessed value.

13. C. The rate is the amount needed divided by total taxable value: $3,000,000 ÷ $200,000,000 = 0.015, which is 15 mills ($15 per $1,000, or $1.50 per $100).
14. D. A special assessment pays for a particular improvement, such as a sidewalk or sewer, and is charged only to benefited properties, often by front footage. It is an involuntary lien, not a general ad valorem tax.
15. A. Real property tax and special-assessment liens take priority over other liens, even an earlier-recorded mortgage. That is why lenders collect taxes through escrow accounts.
16. D. The rule requires disclosure, not removal: disclosure of known paint and reports, the pamphlet, the warning statement, a 10-day testing opportunity and 3 years of record keeping. Watch the word EXCEPT.
17. C. Radon is a natural radioactive gas that enters buildings through foundations; it can be detected only by testing, and the EPA recommends fixing homes at 4 pCi/L or more. A describes asbestos and B lead.
18. A. CERCLA liability requires no proof of fault, can fall entirely on any one responsible party and reaches disposal before 1980. A current owner can be liable for others' dumping, and an "as is" clause does not bind the government.
19. B. The innocent landowner defense, added by SARA in 1986, requires all appropriate inquiry before purchase — in practice a Phase I assessment — and no knowledge or reason to know of the contamination.
20. D. Zones beginning with A or V are special flood hazard areas, and a federally backed loan on a building there requires flood insurance. Standard homeowners policies exclude flood.

PORTFOLIO PIECE: MY PATHWAY FILE — LAND USE, TAXES AND THE ENVIRONMENT

Assemble the land-use section of your Pathway File: the PETE map of your own county with its worked partial-taking calculation (3.1); the zoning fact sheet for a real parcel, with the scaled drawing of setbacks, buildable footprint and coverage (3.2); the buyer's summary of a real association packet, with the sharing rule and a computed special assessment (3.3); the rebuilt tax statement showing every district's levy, the rate in mills and per $100, and the pretend property's tax and assessment (3.4); and the environmental due-diligence checklist with the flood-zone lookup and the nearest Superfund site (3.5).

Close the section with a one-page memo to a pretend first-time buyer titled "Five Things No One Sees at a Showing": name one limit from each lesson — a government power, a zoning rule, a private covenant, a tax or assessment, and an environmental hazard — and explain in plain words how a buyer finds out about each before signing. Date every page.

LOOK FOR	WHAT IT MEANS
Four powers map	Each power is defined in exam language with a real local example, and the partial-taking calculation separates the part taken from severance damages correctly.
Zoning fact sheet	The district, permitted and conditional uses, and bulk rules are recorded accurately, and the scaled drawing's buildable footprint, coverage and FAR are computed correctly.
Association buyer's summary	The summary names the documents, the restrictions most likely to surprise a buyer with section numbers, the amendment rule, the lien for unpaid dues and a correctly computed assessment share.
Tax statement rebuild	Every levy is listed and summed, the rate is shown in mills, per $100 and as a decimal, and the recomputed tax matches the statement or the difference is explained.
Environmental checklist	All hazards are sorted into building, ground and land with a warning sign and a confirming test or professional for each, and the lead rule, flood zone and Superfund lookup are complete and dated.
Buyer memo	Written in the student's own words, the memo names one limit from each lesson, explains how a buyer discovers it, and keeps

LOOK FOR	WHAT IT MEANS
	the licensee's role to disclosing and referring.

3.1 The Four Powers of Government

OBJECTIVES

- Name the four powers of government over private land (PETE) and define each in exam language.
- Classify any government action — a zoning rule, a highway taking, a tax bill, a state claim to an heirless estate — under the correct power.
- Explain eminent domain: public use, just compensation, condemnation, inverse condemnation and severance damages.
- Compute just compensation for a partial taking as value before minus value after, and separate it into the part taken and severance damages.
- State why police-power regulation ordinarily requires no compensation while eminent domain always does.

> **Warm-up.** Write down every way your city or county touched your family's home this year — a tax bill, a building permit, a trash rule, a road widening, anything. In five minutes, sort your list into piles by what kind of power the government was using. By the end of this lesson you will have exact names for the piles, and there are only four.

WATCH

(P.E.T.E.) Police Powers, Escheat, Taxation, Eminent Domain | Real Estate Exam Prep Videos

The Real Estate Classroom · 10:44

https://www.youtube.com/watch?v=tILny60dwzw

> **WHEN TO WATCH**
> Watch after the first three core ideas; pause at each letter of P.E.T.E. and write the power and one example in your notebook before he gives his.

BACKUP VIDEO

Government Powers: Police Power, Eminent Domain, Taxation, & Escheat | Real Estate Exam Prep

PrepAgent · 3:52

https://www.youtube.com/watch?v=33A3IMy9z9o

A short second pass — watch it the day of the practice set and pause before each power to say its definition and an example aloud.

KEY TERMS

police power

The government's power to regulate the use of property to protect public health, safety, morals and general welfare, ordinarily without paying compensation.

eminent domain

The government's power to take private property for public use upon payment of just compensation.

condemnation

The legal proceeding by which a government or authorized entity exercises eminent domain and acquires title to private property.

just compensation

The payment owed for property taken by eminent domain, measured by its fair market value at the time of the taking.

inverse condemnation

A lawsuit by an owner against a government that has effectively taken or damaged the owner's property without bringing a condemnation action.

severance damages

Compensation for the loss in value of the remaining land when only part of a parcel is taken.

taxation

The government's power to levy taxes on real property to raise revenue, enforced by a lien that can lead to a tax sale.

escheat

The reversion of property to the state when an owner dies without a will and without heirs, or when property is abandoned as defined by state law.

public use

A purpose that serves the public — roads, schools, utilities, public buildings — required before eminent domain may be used.

PETE

The memory aid for the four government powers over land: Police power, Eminent domain, Taxation, Escheat.

CORE IDEAS

The story. On December 15, 1791, Virginia ratified the amendments we call the Bill of Rights, and the Fifth Amendment became law. At its end is a single clause on land: "nor shall private property be taken for public use, without just compensation." For eighty years the national government hardly used it; when it needed a fort or a post office, it usually asked a state to condemn the land. Then in 1872 Congress authorized a site in Cincinnati for a custom house and post office, to be acquired by purchase or condemnation. The United States went to court to condemn it, and Kohl, who held an interest in the land, carried a challenge to the Supreme Court. In *Kohl v. United States* (1876), Justice William Strong wrote that the federal government holds the power of eminent domain in its own right, as an attribute of sovereignty. The Fifth Amendment did not create the power — it *tamed* it, with two conditions: a public use, and just compensation.

How they figured it out. English and colonial law let the sovereign take land for roads, mills and forts, but payment was uncertain. The founders wrote payment into the Constitution, and courts spent a century defining the words. **Public use** came to

include roads, schools, courthouses, parks, water lines, airports and the lines of utilities and railroads authorized by statute. **Just compensation** came to mean **fair market value** at the time of the taking — what a willing buyer would pay a willing seller — which is why appraisers testify in nearly every condemnation case. In 1897 the Supreme Court held that the rule binds the states too, through the Fourteenth Amendment. Meanwhile a quieter power grew: the power of states and cities to *regulate* land for the common good without buying it. Lawyers named it the **police power**, and by the 1920s it supported the zoning you will study in Lesson 3.2.

The big idea. Every parcel of private land, even one held in fee simple absolute, is subject to four powers of government — the exam's memory aid is **PETE. Police power** regulates the use of property to protect public health, safety, morals and general welfare: zoning, building codes, subdivision rules, environmental and fire codes. **Eminent domain** *takes* private property for public use upon payment of just compensation; **condemnation** is the court process that exercises it. **Taxation** raises revenue from real property, enforced by a lien that can end in a tax sale. **Escheat** returns property to the state when an owner dies **intestate** (without a will) and with no heirs. One test separates the first two powers, and the exam uses it constantly: police power *regulates* and ordinarily pays nothing; eminent domain *takes* and always pays.

Eminent domain has its own vocabulary. Federal, state, county and city governments and school districts may condemn, and so may **quasi-public** bodies such as utilities and railroads when a statute grants the power. The owner receives an appraisal and an offer; if they cannot agree, a court sets the value. When only part of a parcel is taken, the owner is paid for the land taken *plus* **severance damages**, the drop in value of the remainder. Appraisers measure the award as value before minus value after. In this example, a farm worth $800,000 loses a strip worth $100,000, and the split remainder is worth $640,000: the award is $160,000, of which $60,000 is severance damages. When a government damages or effectively takes property without filing a case — flooding it with a dam, flying aircraft too low to use it — the owner may sue for **inverse condemnation**.

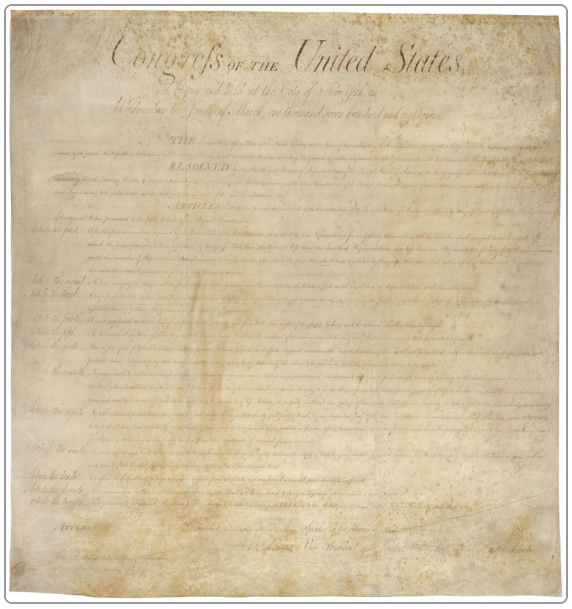
The police power is broader and cheaper for government, so its limits matter. A regulation is valid if it bears a reasonable relation to health, safety, morals or welfare and is not arbitrary, and it may lower a property's value without any payment. A setback rule, a height limit, a ban on factories in a residential district, an order

declaring an unsafe building unfit to occupy — all police power. (Trap: a building "condemned" as unsafe is police power, not eminent domain; the owner keeps title.) A regulation can go "too far" and become a **regulatory taking** requiring compensation — most clearly when it leaves no economically viable use at all — but that is the rare edge, and the exam tests the rule. Taxation falls on every parcel through the ad valorem property tax and on specific parcels through special assessments (Lesson 3.4), and an unpaid tax becomes a lien with priority over almost every other claim.

Escheat is the least used and most often misread power. It answers a simple problem: land must always have an owner. When a person dies with a valid will (**testate**), the will controls; with no will (**intestate**), state law names the heirs — spouse, children, parents, siblings, then more distant relatives in a fixed order. Only when there is no will *and* no heir who can inherit does the property escheat to the state, or in some states the county. A person whose will leaves land to a friend or a church has not left it to escheat, even with no living relatives. States also apply unclaimed-property laws to abandoned bank accounts and other personal property. Each power answers a public need: police power keeps neighbors safe from one another, eminent domain builds what everyone uses, taxation pays for it, and escheat makes sure no land is left ownerless.

On the exam today. Expect two or three questions. The classic is classification: "A city adopts a zoning ordinance. This is an exercise of —" police power. Its twin: "A county takes land for a new school" — eminent domain, with just compensation at fair market value. Know **condemnation** as the process and **inverse condemnation** as the owner's suit, and that escheat requires *both* no will and no heirs. The traps are reliable: calling a zoning change a taking that must be paid for; thinking eminent domain needs the owner's consent (it needs only public use and just compensation); thinking just compensation means the asking price or the original purchase price; thinking only the federal government can condemn (states, cities, school districts and authorized utilities can); and confusing a building "condemned" as unsafe with eminent domain. If a question mentions a partial taking, look for severance damages.

PICTURE STUDY



The Bill of Rights (engrossed copy, articles of amendment), First Federal Congress of the United States, 1789 · Ink on parchment · National Archives, Washington, D.C.

Image: Wikimedia Commons, public domain

In September 1789 the First Congress approved twelve proposed amendments to the Constitution, and clerks copied them in careful script onto parchment to send to the states. Ten were ratified by December 15, 1791, and became the Bill of Rights. This is the federal government's own engrossed copy, kept today in the National Archives. It opens this lesson because the four powers of government over land are old, but the promise that limits the most dramatic of them — eminent domain — is written here, in one line of the article the clerks numbered seventh.

Look closely

- Find the left-hand margin labels. The parchment lists twelve articles, not ten; the first two were not ratified with the others, so "Article the third" became our First Amendment.
- Count down to "Article the seventh." That is our Fifth Amendment, and its last clause is the takings clause: no private property taken for public use without just compensation.
- Look at the heading: "Congress of the United States, begun and held at the City of New-York." The capital was then New York, not Washington.

- Notice the signatures near the bottom. A law of land, like a deed, is completed by the signatures of those with authority to make it.

Talk about it

1. Why do you think the founders put the just-compensation rule into the Constitution instead of leaving it to ordinary law?
2. Which of the four powers does this parchment limit directly, and which does it leave largely untouched?
3. Naboth refused to sell his inheritance to a king (1 Kings 21). How does the takings clause protect both the public's need and the owner's dignity — and what does it ask of a government that wants a neighbor's land?

PROJECT

The PETE Map of Your Own County

You will build a one-page map of how the four powers of government touch real land in your own county, using its public websites. The result is a reference sheet you will reuse in Lessons 3.2 and 3.4 and again in Unit 10 when you study your state portion. Use only public information, and copy no one's private details beyond what an exercise needs.

You will need

- Your county's assessor or treasurer website and your city's planning or permit website
- Your exam notebook and a ruler
- One sheet of paper divided into four quadrants labeled P, E, T and E
- Optional: a local newspaper archive for a recent road or school project

Steps

1. Label the four quadrants Police power, Eminent domain, Taxation and Escheat, and write the one-line exam definition of each at the top of its box.
2. Police power: find your city's zoning map or building-permit page and list three rules it enforces (a setback, a height limit, a permit requirement). Note that none of them pays the owner.
3. Eminent domain: find one public project in your county that needed land (a road widening, a school, a water line). Write who acquired the land and what public use it serves; if records show a purchase or condemnation, note it.
4. Taxation: find the property-tax page and write the name of the office that assesses value and the office that collects the tax.
5. Escheat: find your state's unclaimed-property page and write one sentence on what it does; add one sentence on when real estate escheats (no will and no heirs).
6. Below the quadrants, solve the worked-example farm taking again with your own pretend numbers: value before, value after, part taken, severance damages.

7. Date the page and file it in your Pathway File as “The Four Powers — My County.”

EXAM NOTEBOOK

1. Make flashcards for PETE, condemnation, inverse condemnation, just compensation, severance damages and escheat — front: the term; back: the definition and one example.
2. Draw a four-column table — Police power | Eminent domain | Taxation | Escheat — with rows for What it does, Compensation paid?, Example, Who exercises it.
3. Write a five-line trap list titled “Government powers,” ending with: Police power REGULATES and pays nothing; eminent domain TAKES and always pays.

KEY FORMULAS

$$\text{Just compensation (partial taking)} = \text{value before} - \text{value after}$$

$$\text{Severance damages} = \text{just compensation} - \text{value of the part taken}$$

$$\text{Value of the part taken} = \text{area taken} \times \text{value per unit of area}$$

From history. In 1946 the Supreme Court heard a case about chickens. Thomas Causby ran a chicken farm near Greensboro, North Carolina, close to an airport used by military bombers and fighters. The planes passed so low over his land that his chickens panicked and many died, and the family could not sleep. In *United States v. Causby* the Court held that the flights had taken an easement over his land for which the government had to pay — a landmark of inverse condemnation and of air rights.

WORKED EXAMPLES

Example 1. Classify each action under PETE: (a) a city requires all new houses to sit at least 25 feet from the street; (b) the state acquires a strip of a ranch for a highway; (c) the county sends a tax bill based on assessed value; (d) a man dies with no will and no living relatives, owning a cabin.

Show solution

1. Ask first: is the government regulating use, taking title, collecting revenue, or receiving property for want of an owner?
2. (a) A setback rule regulates use for safety and welfare and pays nothing — **police power**.
3. (b) The state takes title for a public use and must pay fair market value — **eminent domain**, exercised through condemnation.
4. (c) A bill on assessed value raises revenue — **taxation**.
5. (d) No will and no heir: the cabin passes to the state — **escheat**.

Answer: Police power, eminent domain, taxation, escheat — PETE in order. The deciding question is always what the government is doing to the property.

Example 2. In this example, a 100-acre farm is appraised at $900,000 before the state condemns 10 acres for a highway. Comparable farmland is worth $9,000 per acre, but the highway cuts off the remaining 90 acres from the barn, and appraisers value the remainder at $720,000 after the taking. Find just compensation and the severance damages.

Show solution

1. Just compensation is value before minus value after: $\$900{,}000 - \$720{,}000 = \$180{,}000$.
2. Value of the part taken: $10 \times \$9{,}000 = \$90{,}000$.
3. Severance damages are the rest: $\$180{,}000 - \$90{,}000 = \$90{,}000$.
4. Check: the remainder was worth $90 \times \$9{,}000 = \$810{,}000$ as part of the whole farm and is now worth $720,000; the drop, $90,000, matches.

Answer: Just compensation is $180,000: $90,000 for the 10 acres taken and $90,000 of severance damages for the harm to the 90 acres left.

Example 3. Exam style. A widow dies owning a house. She left a valid will giving the house to her church, and she had no living relatives. What happens to the house?

A. It escheats to the state because she had no heirs

B. It passes to the church under the will

C. The county takes it by eminent domain

D. It is sold at a tax sale and the proceeds go to the state

Show solution

1. Escheat requires two things together: no valid will *and* no heirs.
2. Here there is a valid will, so the property passes by testate succession to the devisee named in it.
3. Having no relatives matters only when there is no will.
4. Eminent domain and tax sales have nothing to do with the owner's death.

Answer: B. A valid will controls; escheat is the last resort when a person dies intestate and heirless. A is the classic trap.

PRACTICE

1. Easy What do the letters of PETE stand for?

   Show answer

   Police power, eminent domain, taxation and escheat — the four powers every government holds over private land, even land owned in fee simple absolute.

2. Easy A town adopts a building code requiring smoke detectors in every bedroom. Which power is this, and must the town pay owners?

   Show answer

   Police power, because it regulates for public safety. Ordinarily no compensation is owed for a reasonable police-power regulation.

3. Easy What two conditions does the Fifth Amendment attach to the taking of private property?

   Show answer

   The taking must be for a public use, and the owner must receive just compensation — fair market value at the time of the taking.

4. Medium Define inverse condemnation and give one example.

Show answer

An owner's lawsuit against a government that has effectively taken or damaged property without bringing a condemnation action — for example, land repeatedly flooded by a public dam, or rendered unusable by low-flying aircraft.

5. Medium A man dies intestate. His only living relative is a second cousin whom he never met. Does the property escheat?

Show answer

Not if state intestacy law recognizes the cousin as an heir; most states reach distant relatives. Escheat happens only when there is no will and no heir who can inherit under the statute.

6. Medium In this example, the state takes 5 acres of a 50-acre parcel for a road. The parcel was worth $500,000 before; the remainder is worth $420,000 after. What is just compensation?

Show answer

Value before minus value after: $\$500{,}000 - \$420{,}000 = \$80{,}000$.

7. Medium In the previous problem, land in the area sells for $10,000 an acre. Split the award into the part taken and severance damages.

Show answer

Part taken: $5 \times \$10{,}000 = \$50{,}000$. Severance damages: $\$80{,}000 - \$50{,}000 = \$30{,}000$, the loss in value of the 45 acres that remain.

8. Hard A city orders an unsafe, fire-damaged building vacated and "condemned." Has the city exercised eminent domain?

Show answer

No. Declaring a building unfit for occupancy is a police-power action to protect safety; the owner keeps title and receives no compensation. Eminent domain transfers title for public use and requires payment.

9. Hard Can a private electric utility condemn an easement across a farm for a power line? Explain.

Show answer

Yes, where state law grants it the power. Quasi-public entities such as utilities and railroads may exercise eminent domain for a public purpose, but they too must pay just compensation.

10. Hard An owner says the government must pay him because a new zoning rule lowered his land's value by 20%. What is the general rule, and what is the rare exception?

Show answer

The general rule is that a reasonable police-power regulation requires no compensation even if it lowers value. The exception is a regulatory taking — when a regulation goes so far, for example by denying all economically viable use, that courts treat it as a taking requiring compensation.

11. Challenge In this example, a 40-acre parcel worth $6,000 per acre is cut in two by a 4-acre highway strip. The 36 acres left lose access to water and are appraised at $4,500 per acre afterward. Find the total award, the value of the part taken and the severance damages.

Show answer

Before: $40 \times \$6{,}000 = \$240{,}000$. After: $36 \times \$4{,}500 = \$162{,}000$. Award: $78,000. Part taken: $4 \times \$6{,}000 = \$24{,}000$; severance damages: $54,000.

12. Challenge Write three sentences explaining to a worried homeowner how eminent domain differs from simply losing land to the government, using the words public use, fair market value and condemnation.

Show answer

Eminent domain lets a government acquire private land only for a public use such as a road or school, and never for free. Through condemnation, a court makes sure the owner receives just compensation measured by fair market value, with severance damages if only part is taken. The owner cannot refuse the taking itself, but can contest the price — and often does, with an appraiser's help.

COMMON MISTAKES

- Calling a zoning change or building code an exercise of eminent domain. Regulating use is police power and ordinarily pays nothing; eminent domain takes title and always pays.
- Believing eminent domain requires the owner's consent. It requires only public use and just compensation; the owner may contest the price, not the taking.
- Thinking just compensation means the owner's asking price or what the owner originally paid. It means fair market value at the time of the taking.
- Saying property escheats whenever the owner has no relatives. Escheat requires no will AND no heirs; a valid will to a friend or church controls.
- Confusing a building "condemned" as unsafe (police power) with condemnation under eminent domain (a taking of title for public use).
- Forgetting severance damages in a partial taking: the award is value before minus value after, not just the value of the strip taken.

Make it a game · PETE Hand Signals. Agree on four hand signals: a raised palm (Police power — stop!), two hands lifting a box (Eminent domain — taking it), rubbing fingers together (Taxation), and an empty-hands shrug (Escheat — no one left). The reader calls out ten quick scenarios: a setback rule, a highway strip, a school site, a special assessment for sidewalks, an heirless estate, a smoke-detector code, a utility easement, an annual tax bill, a fire-code order, a will leaving land to a church (trick — no signal!). First correct signal earns a point; a wrong signal loses one. Highest score after ten reads the takings clause aloud.

Scripture. "And Ahab spake unto Naboth, saying, Give me thy vineyard, that I may have it for a garden of herbs, because it is near unto my house: and I will give thee for it a better vineyard than it; or, if it seem good to thee, I will give thee the worth of it in money. And Naboth said to Ahab, The LORD forbid it me, that I should give the inheritance of my fathers unto thee." (1 Kings 21:2–3, KJV)

A king wanted his neighbor's land for his own convenience, and Naboth was free to refuse. When Ahab and Jezebel took it anyway by false witness, Scripture records it as a grave injustice. The takings clause draws the same line: government may take land only for a genuine public use and only by paying its worth — never for a ruler's private pleasure, and never for nothing.

3.2 Zoning and Planning: Euclid v. Ambler

OBJECTIVES

- Explain how *Village of Euclid v. Ambler Realty Co.* (1926) established zoning as a valid exercise of the police power.
- Describe the comprehensive plan and the common zoning classifications and bulk rules — setbacks, height, lot coverage, density and buffer zones.
- Distinguish a variance, a conditional (special) use permit, a nonconforming use, a rezoning, downzoning and illegal spot zoning.
- Compute a lot's buildable footprint from its setbacks, and its lot coverage and floor-area ratio.
- Explain building codes, permits, certificates of occupancy, subdivision plat approval and the Interstate Land Sales Full Disclosure Act.

> **Warm-up.** Draw a quick map of the blocks around your home. Mark where houses, stores, offices, churches, schools and any factories or warehouses sit. In five minutes, write two sentences: is there a pattern, and who do you think decided it? Keep the map — this lesson will name every line you drew.

WATCH

Zoning | Real Estate Prep Exam Videos

The Real Estate Classroom · 14:10

https://www.youtube.com/watch?v=BHrI7-L_d30

> **WHEN TO WATCH**
> Watch after the first three core ideas; pause at each key term on screen (master plan, buffer zone, spot zoning, nonconforming use, variance) and write a one-line example of your own.

BACKUP VIDEO

Zoning - City of Euclid v. Ambler Realty: Property Law 101 #49

Sara C Bronin · 7:25

https://www.youtube.com/watch?v=1Cv3D7fqomI

Watch on the project day for the legal reasoning of Euclid; listen for "fairly debatable" and "pig in the parlor," and write each in your notebook with one sentence on what it means.

KEY TERMS

zoning

Local regulation, under the police power, that divides land into districts and controls the use, height, bulk and density of buildings in each.

setback

The minimum required distance between a building and a lot line or street.

variance

Permission from the zoning board to depart from a dimensional requirement because strict application would cause an unnecessary hardship unique to the property.

nonconforming use

A use that was lawful before a zoning change made it nonconforming and may continue, usually without expansion — often called "grandfathered."

downzoning

A rezoning to a less intensive use or lower density, such as from multifamily to single-family.

comprehensive plan (master plan)

A community's long-range plan for land use, transportation, utilities and growth, on which zoning ordinances are based.

buffer zone

A strip of land, often a park or a less intense use, that separates incompatible districts such as residential and industrial.

conditional use permit (special use permit)

Approval for a use that the district allows only if specified conditions are met, such as a church, school or day care in a residential zone.

rezoning (zoning amendment)

A legislative change of a parcel's or area's zoning district by the local governing body.

spot zoning

Rezoning a single parcel inconsistently with the comprehensive plan for the benefit of its owner; generally held illegal.

certificate of occupancy

A document issued by the building department certifying that a structure complies with codes and may lawfully be occupied.

floor-area ratio (FAR)

The total floor area of a building divided by the area of its lot.

CORE IDEAS

The story. In 1922 the Village of Euclid, Ohio, a farming suburb on the edge of Cleveland, adopted a zoning ordinance dividing its twelve-odd square miles into districts for single-family houses, two-family houses, apartments, stores and industry, with limits on height and lot size in each. The Ambler Realty Company owned 68 acres between Euclid Avenue and the Nickel Plate railroad, and it had been holding the land for industry, which was spreading east from Cleveland. The new ordinance zoned much of the tract for houses and apartments. Ambler sued, telling the court that the land was worth about $10,000 an acre for industrial use but no more than $2,500 an acre for residential use. A federal trial court agreed that the ordinance took Ambler's property without compensation. The village appealed, and on November 22, 1926, the Supreme Court reversed by a vote of 6 to 3. Zoning was constitutional.

How they figured it out. Justice George Sutherland's opinion treated zoning as a modern extension of the old law of nuisance. A use may be harmless in one place and harmful in another — in the opinion's most quoted line, a nuisance "may be merely a right thing in the wrong place, like a pig in the parlor instead of the barnyard." If the legislative classification was "fairly debatable," the Court held, the village's judgment must stand. That made zoning an exercise of the **police power**, not eminent domain, so a loss in value — even Ambler's steep one — required no compensation. In the same years the U.S. Department of Commerce published a model Standard State Zoning Enabling Act, and state after state adopted laws delegating zoning power to cities and counties. The separation of uses into districts is still called **Euclidean zoning**, after the village — not the geometer.

The big idea. Zoning is local regulation, under the police power, that divides land into districts and controls what may be built in each and how much. It rests on a **comprehensive plan** (or master plan) — the community's long-range plan for land use, roads, utilities, parks and growth — prepared by a planning commission and adopted by the city or county. The common classifications are **residential** (often

subdivided, such as R-1 single-family and R-3 multifamily), **commercial**, **industrial**, **agricultural** and **mixed use**; many places also allow **planned unit developments**, which trade flexible lot rules for open space. Within each district, **bulk and density** rules shape the building: minimum lot size, **setbacks** from front, side and rear lot lines, maximum height, maximum **lot coverage**, **floor-area ratio** and units per acre. **Buffer zones** — a park, a greenbelt, an office district — separate incompatible uses.

Zoning must bend sometimes, and the exam tests the four ways it bends. A **variance** is permission to depart from a *dimensional* rule — a setback, a height — because the property's peculiar shape or terrain makes strict compliance an unnecessary hardship; the owner applies to the zoning board of adjustment (or appeals), and a hardship the owner created is not enough. A **conditional use permit** (special use permit or special exception) allows a use the ordinance already lists as permissible under conditions — a church, school, hospital or day care in a residential district. A **nonconforming use** was lawful before the rule changed; it is "grandfathered" and may continue, but usually may not be expanded or rebuilt after major destruction, and is often lost if abandoned. A **rezoning** (amendment) changes the district itself by legislative act; **downzoning** moves to a less intense use. **Spot zoning** — rezoning one parcel against the plan for its owner's benefit — is generally illegal.

Zoning says what may be built; **building codes** say how. Codes set minimum standards for structure, fire safety, plumbing, electrical work and energy use. Before construction or major remodeling, the owner obtains a **building permit**; inspectors check the work in stages; and when it complies, the building department issues a **certificate of occupancy**. Work done without permits is a classic disclosure problem for licensees. Before land is divided, **subdivision regulations** require the developer to submit a **plat** showing lots, streets, easements and utilities for approval by the planning authority; the developer typically builds or bonds the streets and utilities and **dedicates** them to the public. Compute two bulk numbers carefully. In this example, a 60×120-foot lot has 7,200 square feet; a 1,800-square-foot house footprint covers $1{,}800/7{,}200 = 25\%$ of it, and a two-story house of 3,600 square feet has a floor-area ratio of 0.5.

One federal law reaches subdivisions sold across state lines. The **Interstate Land Sales Full Disclosure Act** of 1968 was passed after buyers in many states paid for lots in distant developments they had never seen, some of which lacked roads, water or even dry ground. As of 2026 the act is administered by the Consumer Financial

Protection Bureau. Unless an exemption applies — subdivisions with fewer than 25 lots are exempt entirely, and others below 100 lots are exempt from registration — a developer selling lots through interstate commerce must register the subdivision and give each buyer a **property report** before the contract is signed. The buyer may cancel within seven days of signing, and a buyer who never received the report may revoke for up to two years. The pattern for the exam is simple: registration with the federal agency, a property report before signing, and a seven-day cooling-off right. Your own state may add its own subdivision disclosure law; check the state commission.

On the exam today. Expect two or three items. Know that zoning is **police power**, enacted locally and based on the comprehensive plan, and that *Euclid v. Ambler* (1926) upheld it. The heart of the topic is choosing the right tool. Odd-shaped lot, owner wants relief from a side setback: **variance**. A church wants to build in a residential district where churches are allowed with approval: **conditional use permit**. A corner store that predates the residential zoning: **nonconforming use**, which may continue but not expand. A developer asks the council to change a farm from agricultural to commercial: **rezoning**. The traps: a variance cures hardship unique to the land, never a self-created one; a nonconforming use that is abandoned or destroyed may lose its protection; **spot zoning** is illegal; and when zoning and a deed restriction conflict, the more restrictive rule governs (Lesson 3.3). Know also that the certificate of occupancy comes after construction.

PICTURE STUDY



Study for Maximum Mass Permitted by the 1916 New York Zoning Law, Stage 4, Hugh Ferriss, 1922 · Black crayon, pen and ink, brush and wash on illustration board · Cooper Hewitt, Smithsonian Design Museum, New York

Image: Wikimedia Commons, public domain

Hugh Ferriss was a New York architectural artist who drew buildings rather than designing them, and his moody renderings shaped how a generation imagined the city. In 1922 he made a series of four drawings showing, stage by stage, the largest building New York's 1916 zoning law would allow on a city block. The law required towers to step back from the street as they rose, so that light and air could reach the sidewalks. This fourth stage shows the result: a mountain carved by a rule. It opens this lesson because it is zoning made visible — every terrace you see is a setback written into law.

Look closely

- Find the steps. Each setback is the legal "envelope" at work: the higher the building climbs, the farther it must stand back from the street.
- Look at the central tower. The 1916 law allowed a tower of unlimited height over a limited share of the lot — an early version of the bulk rules you computed today.
- Notice that no windows, doors or ornaments appear. Ferriss drew only the mass the law permitted, not any actual design.

- Watch the light fanning behind the mass. Light and air for the street below were the public welfare the zoning law was written to protect.

Talk about it

1. How is a setback in a New York skyscraper district the same rule as a 25-foot front setback in your own neighborhood?
2. Which zoning tool would an owner seek if a corner of the lot made one of these steps impossible to build — a variance or a rezoning? Why?
3. Proverbs 24:27 tells us to prepare the field before building the house. What virtue do planning and zoning ask of a community, and of a single builder?

PROJECT

Read Your Zoning Like a Licensee

You will look up the zoning for one real parcel — your own home or a public building near you — and build a zoning fact sheet like the ones licensees and buyers use before writing an offer. Then you will compute the buildable envelope for a pretend lot under the same rules. Use only public information.

You will need

- Your city or county's online zoning map and zoning code (search "[your city] zoning map")
- Your county assessor's parcel viewer for lot dimensions
- Graph paper, ruler and calculator
- Your exam notebook

Steps

1. Find the parcel on the zoning map and record its district code (for example, R-1 or C-2) and the name of the district.
2. In the zoning code, find the district's list of permitted uses, conditional uses and prohibited uses. Copy three of each.
3. Record the bulk rules: minimum lot size, front, side and rear setbacks, maximum height, maximum lot coverage and any floor-area ratio or density limit.
4. Look up the parcel's approximate lot dimensions on the assessor's viewer.
5. On graph paper, draw a pretend lot with those dimensions to scale, shade the setbacks, and compute the buildable footprint and the largest house the coverage limit allows.
6. Write one sentence each describing when an owner in this district would need a variance, a conditional use permit or a rezoning.
7. Title the page "Zoning Fact Sheet," date it, and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, and pair the four look-alikes on one card each: variance / conditional use / nonconforming use / rezoning — front: the scenario; back: the tool and who grants it.
2. Draw a lot to scale with front, side and rear setbacks shaded, and label the buildable footprint, lot coverage and FAR formulas beside it.
3. Write a five-line trap list titled “Zoning,” ending with: a VARIANCE cures a hardship of the LAND — never a hardship the owner made.

KEY FORMULAS

$$\text{Buildable footprint} = (\text{width} - \text{side setbacks}) \times (\text{depth} - \text{front} - \text{rear setbacks})$$

$$\text{Lot coverage} = \frac{\text{building footprint}}{\text{lot area}} \times 100\%$$

$$\text{Floor-area ratio (FAR)} = \frac{\text{total floor area}}{\text{lot area}}$$

$$\text{Density} = \frac{\text{dwelling units}}{\text{acres}}, \quad 1 \text{ acre} = 43{,}560 \text{ sq ft}$$

From history. New York City adopted America’s first comprehensive zoning code in 1916. The spark was the Equitable Building at 120 Broadway, finished in 1915: forty stories rising straight up from the sidewalk with no setbacks, it cast a shadow over several acres of lower Manhattan and darkened its neighbors’ windows. The 1916 Zoning Resolution answered with use districts and the stepped “envelope” that Hugh Ferriss later drew — the wedding-cake skyline of the 1920s.

WORKED EXAMPLES

Example 1. In this example, a lot is 80 feet wide and 150 feet deep. The R-1 zone requires a 25-foot front setback, a 30-foot rear setback and 10-foot side setbacks on each side. What is the largest possible ground-floor footprint inside the setbacks?

Show solution

1. Usable width: subtract both side setbacks: $80 - 10 - 10 = 60$ ft.
2. Usable depth: subtract front and rear setbacks: $150 - 25 - 30 = 95$ ft.
3. Buildable footprint: $60 \times 95 = 5{,}700$ sq ft.
4. Check against the lot area, $80 \times 150 = 12{,}000$ sq ft: the envelope is $5{,}700 / 12{,}000 = 47.5\%$ of the lot. A lot-coverage limit may cut it further.

Answer: 5,700 square feet, before any lot-coverage limit is applied. Remember to subtract BOTH side setbacks.

Example 2. Name the zoning tool. (a) A lot has a steep ravine across its back half, so a house cannot meet the 30-foot rear setback. (b) A day care wants to open in an R-1 district where the ordinance allows day cares with board approval. (c) A gas station built in 1950 now sits in a district rezoned residential in 1975. (d) A developer asks the council to change 40 acres from agricultural to commercial.

Show solution

1. (a) Relief from a dimensional rule because of a hardship unique to the land and not created by the owner — a **variance**.
2. (b) A use the ordinance already allows if conditions are met — a **conditional (special) use permit**.
3. (c) Lawful before the change, allowed to continue — a **nonconforming use**; it generally may not expand.
4. (d) A legislative change of the district itself — a **rezoning** (zoning amendment). If done for one parcel against the plan, it would be spot zoning.

Answer: Variance, conditional use permit, nonconforming use, rezoning.

Example 3. Exam style. In this example, a 10,000-square-foot lot is zoned for a maximum lot coverage of 35% and a maximum floor-area ratio of 0.6. An owner proposes a two-story house with a 3,200-square-foot footprint and 6,400 square feet of floor area. Which is true?

A. It complies with both limits

B. It violates lot coverage only

C. It violates FAR only

D. It violates both limits

Show solution

1. Lot coverage: $3{,}200/10{,}000 = 32\%$, under the 35% limit — complies.
2. FAR: $6{,}400/10{,}000 = 0.64$, over the 0.6 limit — violates.
3. The largest allowed floor area is $0.6 \times 10{,}000 = 6{,}000$ square feet, so the owner must trim 400 square feet or seek a variance.

Answer: C. Coverage is 32% (allowed) but the FAR is 0.64 (over 0.6). Coverage counts only the footprint; FAR counts every floor.

PRACTICE

1. Easy Under which government power is zoning enacted, and which Supreme Court case upheld it?

   Show answer

   Zoning is an exercise of the police power, upheld in *Village of Euclid v. Ambler Realty Co.* (1926).

2. Easy What document is zoning supposed to carry out?

   Show answer

   The comprehensive (master) plan — the community's long-range plan for land use, transportation, utilities and growth.

3. Easy What is a buffer zone? Give an example.

   Show answer

   Land that separates incompatible districts, such as a park or an office district between a residential neighborhood and an industrial area.

4. **Medium** A homeowner wants to build a garage 3 feet into a required side setback because she wants a bigger garage. Is she a good candidate for a variance?

Show answer

No. A variance requires an unnecessary hardship arising from the property's unique conditions; wanting a larger garage is a self-created preference, not a hardship of the land.

5. **Medium** In this example, a 75-by-140-foot lot has a 20-foot front setback, a 25-foot rear setback and 8-foot side setbacks on each side. What is the buildable footprint?

Show answer

Width $75 - 8 - 8 = 59$ ft; depth $140 - 20 - 25 = 95$ ft; footprint $59 \times 95 = 5{,}605$ square feet.

6. **Medium** A small grocery has operated since 1960. In 1990 the area was zoned residential. Can the grocery stay? Can it add a second building?

Show answer

It may stay as a legal nonconforming use, but generally it may not expand or add a building; many ordinances also end the protection if the use is abandoned or the building is largely destroyed.

7. **Medium** What is spot zoning, and why do courts usually strike it down?

Show answer

Rezoning a single parcel in a way inconsistent with the comprehensive plan, for the benefit of its owner. Courts treat it as arbitrary rather than a reasonable police-power regulation for the general welfare.

8. **Hard** In this example, a 1-acre lot (43,560 sq ft) is zoned for a maximum density of 8 units per acre. A developer proposes 10 townhouses on it. What is the problem, and what could the developer request?

Show answer

Ten units on one acre exceeds the 8-units-per-acre limit. The developer would need a rezoning (or another approval the ordinance provides, such as a planned unit development) to build more than 8 units.

9. Hard What is the difference between a building permit and a certificate of occupancy?

Show answer

A building permit authorizes construction to begin according to approved plans; a certificate of occupancy is issued after construction passes inspection and certifies the building may lawfully be used.

10. Hard A developer in Arizona sells 300 lots by mail to buyers in Washington. Under the Interstate Land Sales Full Disclosure Act, what must buyers receive, and what right do they have?

Show answer

Unless an exemption applies, each buyer must receive a property report before signing and may cancel the contract within seven days; a buyer who never received the report may revoke for up to two years.

11. Challenge In this example, a 12,000-square-foot lot allows 30% lot coverage and an FAR of 0.5. What is the largest footprint and the largest total floor area? Could a one-story house use all of the FAR?

Show answer

Largest footprint: $0.30 \times 12{,}000 = 3{,}600$ sq ft. Largest floor area: $0.5 \times 12{,}000 = 6{,}000$ sq ft. A one-story house is capped at 3,600 sq ft by coverage, so it cannot use the full FAR; a second story would be needed.

12. Challenge Ambler Realty claimed its land fell from about $10,000 to $2,500 an acre because of zoning. Explain why the Court allowed that loss without compensation, using the words police power, nuisance and fairly debatable.

Show answer

The Court treated zoning as a police-power regulation, like the law of nuisance, which keeps uses out of places where they would harm neighbors. Because the classification was fairly debatable, the legislature's judgment controlled, and a reasonable regulation that lowers value is not a taking requiring payment.

COMMON MISTAKES

- Calling zoning an exercise of eminent domain. Zoning is police power and ordinarily pays nothing.

- Granting a variance for a self-created hardship. A variance cures a hardship unique to the land, not one the owner made or a mere wish for more profit.
- Confusing a conditional use permit with a variance. A conditional use is a USE the ordinance allows with approval; a variance is relief from a DIMENSIONAL rule.
- Thinking a nonconforming use may expand or be rebuilt freely. It may continue, but expansion is usually barred and abandonment or destruction can end it.
- Treating spot zoning as a normal rezoning. Rezoning one parcel against the comprehensive plan for its owner's benefit is generally illegal.
- Subtracting only one side setback when computing a buildable footprint. Side setbacks apply to both sides.

Make it a game · Which Tool?. Write four cards: VARIANCE, CONDITIONAL USE, NONCONFORMING USE, REZONING, and give every player a set. The reader describes a situation — a lot with a creek that blocks the rear setback, a church in a residential zone, a 1950s barbershop in a district rezoned residential, a farm the owner wants changed to commercial, a homeowner who just wants a bigger deck. Everyone flips a card at once; matching the reader's answer earns a point. For a self-created hardship, the right move is to flip nothing at all. Ten rounds; the winner explains spot zoning in one sentence.

Scripture. "Prepare thy work without, and make it fit for thyself in the field; and afterwards build thine house." (Proverbs 24:27, KJV)

Solomon counsels order: first the field, then the house. A comprehensive plan asks the same of a whole community — roads, water and uses arranged before the building begins — and zoning is that plan put into law. A builder who honors the plan, and a neighbor who honors the rules, practice the patient foresight this proverb commends.

3.3 Private Controls: Deed Restrictions, CC&Rs and Owners' Associations

OBJECTIVES

- Define deed restrictions and subdivision covenants, conditions and restrictions (CC&Rs), and explain how a restrictive covenant runs with the land.
- Contrast a covenant (remedy: injunction or damages) with a condition (remedy: forfeiture or reversion of title).
- List the ways private restrictions are enforced and terminated — expiration, agreement, abandonment, laches, merger and changed conditions.
- Explain how homeowners' and condominium associations govern: declaration, bylaws, rules, dues, special assessments, liens and architectural review.
- Apply the rule that when public and private restrictions conflict, the more restrictive generally governs, and compute an owner's share of an association assessment.

> **Warm-up.** Imagine your family buys a house and finds a paper in the closing packet saying you may not paint it purple, park a boat in the driveway or put up a fence taller than four feet. In five minutes, write down who you think wrote those rules, who can enforce them, and whether the city has anything to do with them. Then guess what happens if you ignore them.

WATCH

06 Deed Restrictions: Arizona Real Estate License Exam Prep

Hogan School of Real Estate, Inc. · 4:51

https://www.youtube.com/watch?v=9TgF4GJvYE0

> **WHEN TO WATCH**
> Watch after the third core idea; note every remedy he names (injunction especially) and the reason he gives for why some old restrictions are unenforceable.

BACKUP VIDEO

What are Real Estate Deed Restrictions?

US Realty Training · 4:46

https://www.youtube.com/watch?v=B_XnC97BYF8

A second explanation of deed restrictions — watch before the project and list every example restriction he names; then find the closest rule in your sample declaration.

KEY TERMS

deed restriction

A private limitation on the use of land placed in a deed by a grantor, binding the grantee and usually later owners.

covenants, conditions and restrictions (CC&Rs)

A recorded declaration by a developer imposing uniform private restrictions on every lot in a subdivision or condominium.

restrictive covenant

A promise in a deed or declaration limiting the use of land, enforceable by injunction or damages.

condition

A deed provision whose breach can end the owner's estate and return title to the grantor or heirs (forfeiture or reversion).

runs with the land

Binds or benefits every later owner of the land, not just the original parties.

injunction

A court order requiring a party to stop doing something or to undo something done in violation of a restriction.

laches

An equitable defense that bars enforcement when the party entitled to enforce waited unreasonably long and the delay harmed the other party.

special assessment (association)

A one-time charge levied by an owners' association on its members for a specific expense, such as a new roof or road repair.

merger (of restrictions)

Termination of a covenant when the benefited and burdened lands come under one owner.

homeowners' association (HOA)

An organization of lot owners created by the subdivision declaration to manage common areas and enforce the CC&Rs, funded by assessments.

architectural review committee

An association committee that approves or denies owners' proposed exterior changes under the CC&Rs.

CORE IDEAS

The story. In 1853 a New York merchant named Llewellyn Haskell began buying wooded land on the slopes of the Orange Mountains in New Jersey, a short train ride from Manhattan. With the architect Alexander Jackson Davis he planned something new: a neighborhood of country houses built around a park. About fifty acres along a stream-cut ravine — the "Ramble" — were set aside as common land belonging to the lot owners together, and the lots were sold with deeds that bound buyers to the terms of the 1857 arrangement. Every owner paid a yearly fee, figured by the acre, to keep the common land in order, and the owners managed it through a committee of their own. Llewellyn Park, as it was named, is often called the first planned residential community in America, and Thomas Edison later made his home there. Its idea — private rules, recorded with the land, enforced by the neighbors themselves — now governs tens of millions of American homes.

How they figured it out. The law that makes such rules last came from London. In 1808 a man named Tulk sold the garden in the middle of Leicester Square, and the buyer promised to keep it an open garden. Years later the garden was resold to a Mr. Moxhay, whose deed did not repeat the promise, and Moxhay planned to build on it. In *Tulk v. Moxhay* (1848), the English court of chancery issued an **injunction**: a buyer

who takes land with notice of a restriction is bound by it, whether or not his own deed mentions it. American courts adopted the rule, and recording supplied the notice — a restriction in the public records gives **constructive notice** to every later buyer. Developers soon learned to record one declaration for an entire subdivision, so that every lot carried the same rules and every owner could enforce them against every other. The modern homeowners' association grew from those recorded declarations.

The big idea. Government controls land through the police power; private parties control it through **private restrictions**. A **deed restriction** is placed by a grantor in a single deed — no commercial use, no building within 50 feet of the creek. **Covenants, conditions and restrictions** (**CC&Rs**) are recorded by a developer in a **declaration** that binds every lot in a subdivision or condominium — minimum house size, approved colors, fence heights, parking, pets, rentals. A properly created restriction **runs with the land**, binding later owners who take with notice, and recording gives that notice. The law distinguishes two forms. A **covenant** is a promise; if it is broken, neighbors or the association may sue for an **injunction** or **damages**. A **condition** is harsher: breach can end the estate and return title to the grantor through a right of re-entry. Courts dislike forfeitures, so ambiguous language is read as a covenant.

Private restrictions are enforced privately. The city does not enforce CC&Rs; the association or the owners who benefit from them do, usually by asking a court for an injunction ordering the violator to stop or to remove the offending fence or shed. Restrictions end in several named ways: by **expiration** of a stated term; by **agreement** of the owners under the voting rules in the declaration; by **abandonment**, when violations are so widespread that the original plan is gone; by **laches**, when the party entitled to enforce waited unreasonably long while the violator relied on the silence; by **merger**, when one owner acquires all the benefited and burdened land; and by a **change in neighborhood conditions** so great that the restriction can no longer serve its purpose. Some covenants were never enforceable. In *Shelley v. Kraemer* (1948) the Supreme Court held that courts may not enforce racially restrictive covenants, and the Fair Housing Act of 1968 made such covenants unlawful; any surviving in old records are void.

An **owners' association** is created by the declaration and governed by articles of incorporation, **bylaws** (how the board is elected and meets) and **rules and regulations** adopted by the board. It maintains common areas and amenities,

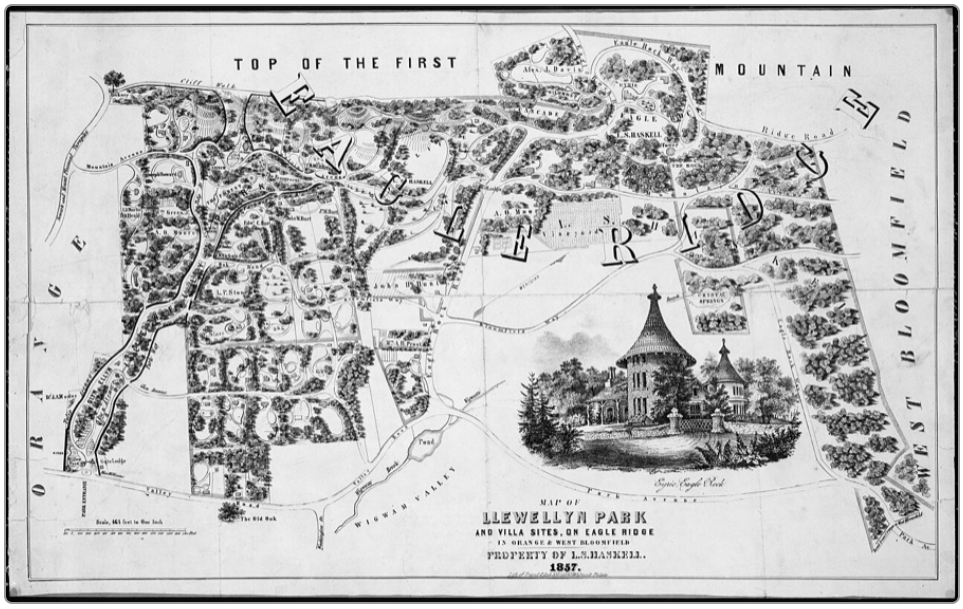
enforces the CC&Rs, and funds itself with regular **dues** (assessments) and, when a large expense arises, **special assessments**. It usually keeps a **reserve fund** for future repairs. Unpaid assessments become a **lien** on the owner's lot that, under state law, may be foreclosed. An **architectural review committee** approves exterior changes. A **condominium association** works the same way for a building's common elements. Shares are usually equal per lot or set by each unit's percentage interest. In this example, a 60-unit condominium needs a $180,000 roof; a unit with a 1.5% interest owes $0.015 \times \$180{,}000 = \$2{,}700$. Before closing, a licensee should obtain the association's resale documents showing dues, pending special assessments and any violations.

Private and public controls overlap, and the exam has a firm rule for conflicts: **the more restrictive generally governs**. If the zoning allows duplexes but the CC&Rs require single-family houses, only a single-family house may be built — the zoning does not override the private covenant. If the CC&Rs allow a 40-foot house but the zoning caps height at 35 feet, the 35-foot limit controls. Both bind the owner at once, and complying with one is no defense to violating the other. Two more practical points belong in your notebook. First, a buyer is bound by recorded restrictions whether or not he read them, because recording is constructive notice — which is why buyers should review the declaration, bylaws, rules and budget before committing, and why many states give buyers of association-governed property a right to receive and review those documents. Second, restrictions are not all negative: a declaration may also require owners to pay assessments and keep up their property, and those affirmative duties bind later owners too.

On the exam today. Expect two to four items. Know the vocabulary — deed restriction, CC&Rs, declaration, restrictive covenant, runs with the land — and the two remedies: a covenant is enforced by **injunction** (or damages), a condition by **forfeiture** or reversion of title. Expect the conflict question — zoning allows one thing, the CC&Rs forbid it — and answer with the more restrictive rule. Expect a termination question naming laches, abandonment, expiration or merger. The traps: thinking the city enforces CC&Rs (owners and the association do); thinking a buyer who never saw the recorded restrictions is free of them (recording gives constructive notice); thinking zoning overrides a stricter covenant; thinking a racially restrictive covenant can still be enforced (it is void); and forgetting that unpaid association

assessments become a lien. A question about who approves a new fence color points to the **architectural review committee.**

PICTURE STUDY



Map of Llewellyn Park and Villa Sites, on Eagle Ridge in Orange & West Bloomfield, Alexander Jackson Davis, 1857 · Lithograph · The Metropolitan Museum of Art, New York

Image: Wikimedia Commons, public domain

Alexander Jackson Davis was one of America's leading architects of the mid-1800s, known for picturesque country houses and Gothic villas. He drew this promotional map in 1857 for Llewellyn Haskell, whose new park in the Orange Mountains offered buyers wooded "villa sites" around land they would own and govern together. Every curve of road here was planned and every lot was sold subject to the same arrangement. The map opens this lesson because it is a picture of private land-use control at its birth: a whole neighborhood shaped not by a city ordinance but by a recorded plan and the promises in its deeds.

Look closely

- Follow the winding roads. Unlike a city grid, they were laid out to fit the terrain — a choice made by the developer and fixed by the plan.
- Find the long wooded ravine through the middle. That is the commonly held land the owners paid to maintain together — the ancestor of every HOA common area.
- Read the owners' names written on the lots. Each name is a buyer who accepted the same terms in his deed.
- Look at the inset villa. Advertising the kind of house that belonged there was itself a way of setting the neighborhood's standard.

Talk about it

1. What would a buyer of one of these villa sites have gained by accepting the same rules as every neighbor? What would he have given up?
2. If one owner ignored the agreement and fenced off part of the common ravine, who could enforce the rules, and what would they ask a court for?
3. Psalm 15 praises the one who “sweareth to his own hurt, and changeth not.” Why does a neighborhood built on recorded promises depend on that kind of character?

PROJECT

The Association Packet Review

You will review a real or sample set of association documents the way a careful buyer's agent would, and write a one-page summary for a pretend buyer. Many associations and condominium projects post their declaration, bylaws and rules online; your county recorder may also show a recorded declaration. Use public documents only and copy no one's personal information.

You will need

- A publicly posted HOA or condominium declaration (CC&Rs), bylaws and rules — or a sample set from a state agency or your teacher
- Your exam notebook and a highlighter
- A calculator
- One sheet of paper for the buyer summary

Steps

1. Identify the document types you have: declaration (CC&Rs), articles, bylaws, rules. Write one sentence on what each does.
2. List five restrictions a buyer would care about most — rentals, pets, parking, fences, exterior colors — and quote the section number of each.
3. Find how the restrictions can be amended or terminated (what vote of owners) and whether they have a stated term.
4. Find how dues and special assessments are set and how they are shared (equally, by square footage or by percentage interest), and what happens if an owner does not pay (look for the word lien).
5. Compute a sample owner's share of a pretend $150,000 special assessment under the document's sharing rule.
6. Find who approves exterior changes and how long the committee has to answer.
7. Write a one-page "Buyer's Summary" beginning with the three rules most likely to surprise a buyer, date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, with a paired card for COVENANT (injunction or damages) vs. CONDITION (forfeiture, re-entry).
2. Draw a two-column chart, PUBLIC CONTROLS (zoning, codes, subdivision rules — enforced by government) and PRIVATE CONTROLS (deed restrictions, CC&Rs — enforced by owners and the association), with an arrow between them labeled "conflict: the more restrictive governs."
3. Write a five-line trap list titled "CC&Rs," ending with: RECORDED = NOTICE. A buyer is bound by recorded restrictions whether or not he read them.

KEY FORMULAS

$$\text{Owner's share} = \text{total assessment} \times \text{owner's percentage interest}$$

$$\text{Equal share} = \frac{\text{total assessment}}{\text{number of lots or units}}$$

$$\text{Monthly dues} = \frac{\text{annual budget share}}{12}$$

From history. Boston's Louisburg Square, on Beacon Hill, may hold America's oldest homeowners' association. Its brick row houses face a small private park that the owners hold in common. In 1844 twenty-eight lot owners signed an indenture and articles of agreement binding themselves and every later owner to care for the park together, under an elected committee that levies an annual assessment. The square's owners still maintain the park — and lock its gate — today.

Example 1. In this example, the zoning for a lot permits single-family houses up to 35 feet tall and allows detached accessory apartments. The subdivision's recorded CC&Rs limit houses to 30 feet and forbid any second dwelling on a lot. The owner wants a 33-foot house with a backyard cottage to rent. What may she build?

Show solution

1. Both the zoning and the CC&Rs bind the lot at once.
2. Height: zoning allows 35 feet, CC&Rs allow 30. The more restrictive rule governs — 30 feet.
3. Second dwelling: zoning allows it, the CC&Rs forbid it. The more restrictive rule governs — no cottage.
4. The city will issue permits under zoning, but the association or neighbors can obtain an injunction under the CC&Rs.

Answer: A single-family house no taller than 30 feet and no cottage. When public and private rules conflict, the more restrictive controls.

Example 2. A 1950 deed reads: “Grantee covenants that no commercial business shall be conducted on the premises.” A second deed in the same town reads: “to Grantee, but if the premises are ever used for commercial purposes, Grantor may re-enter and reclaim title.” Both current owners open shops. What remedy fits each deed?

Show solution

1. The first is a **covenant** — a promise. The benefited parties may seek an injunction ordering the business closed, or damages.
2. The second is a **condition** (fee simple subject to a condition subsequent). Breach gives the grantor or heirs a right of re-entry to end the owner’s estate.
3. Courts read ambiguous language as a covenant because forfeiture is harsh; here the second deed is unambiguous.
4. Either remedy may be lost by laches if the grantor or neighbors wait unreasonably long.

Answer: Deed one: injunction or damages. Deed two: forfeiture by re-entry. Covenant = promise; condition = title at risk.

Example 3. Exam style. In this example, an 80-lot subdivision’s association must replace a private road for $320,000. The declaration divides special assessments equally among lots, and the association collects in two equal installments. What does one owner pay per installment?

A. $1,000

B. $2,000

C. $4,000

D. $8,000

Show solution

1. Equal share per lot: $\$320{,}000 \div 80 = \$4{,}000$.
2. Two installments: $\$4{,}000 \div 2 = \$2{,}000$.
3. C is the whole share; B is one installment. Read the last line of the stem.

Answer: B. $2,000 per installment — $4,000 in all. Unpaid, it would become a lien on the lot.

PRACTICE

1. Easy What is the difference between a deed restriction and CC&Rs?

Show answer

A deed restriction is placed by a grantor in a single deed; CC&Rs are recorded by a developer in a declaration that binds every lot in a subdivision or condominium.

2. Easy What does it mean that a covenant "runs with the land"?

Show answer

It binds (or benefits) every later owner of the land, not just the original parties, so long as the later owner takes with notice — which recording provides.

3. Easy Who enforces CC&Rs — the city or the owners?

Show answer

The owners and the association. The city enforces zoning and codes; private restrictions are enforced privately, usually by injunction.

4. Medium Zoning allows a 6-foot fence; the CC&Rs allow 4 feet. How tall may the fence be? Why?

Show answer

Four feet. When public and private restrictions conflict, the more restrictive generally governs, and the owner must satisfy both.

5. Medium A deed provides that if a billboard is ever erected on the land, the grantor may re-enter and reclaim title. Is this a covenant or a condition, and what is the remedy?

Show answer

A condition. Breach gives the grantor or heirs the right to end the estate and reclaim title (re-entry), not merely an injunction.

6. Medium Name four ways a restrictive covenant can end.

Show answer

Any four of: expiration of its term, agreement of the owners under the declaration, abandonment through widespread violation, laches, merger of the benefited and burdened lands, a radical change in neighborhood conditions, or condemnation.

7. Medium In this example, a 120-unit condominium levies a $540,000 special assessment shared by percentage interest. A unit holds a 0.9% interest. What is its share?

Show answer

$0.009 \times \$540{,}000 = \$4{,}860$.

8. Hard Neighbors watched an owner operate a small woodshop in violation of the CC&Rs for nine years, saying nothing while he built a large workshop. Now they sue. What defense may he raise?

Show answer

Laches — the neighbors waited unreasonably long while he relied on their silence and invested in the workshop. Courts may refuse an injunction for that reason; a long pattern of tolerated violations might also support an abandonment argument.

9. Hard Why are old racially restrictive covenants found in some recorded deeds unenforceable today?

Show answer

In *Shelley v. Kraemer* (1948) the Supreme Court held that courts may not enforce them, and the Fair Housing Act of 1968 made them unlawful. They are void, whatever the old record says.

10. Hard An owner stops paying HOA dues. What can the association do, in general terms?

Show answer

Unpaid assessments become a lien on the owner’s lot; depending on state law the association may sue, charge late fees and interest, and in many states foreclose the lien.

11. **Challenge** In this example, an HOA's annual budget is $216,000 for 150 lots sharing equally. What are monthly dues per lot? If a $45,000 special assessment is added, what does each lot owe for it?

    Show answer

    Annual share: $\$216{,}000 \div 150 = \$1{,}440$; monthly: $120. Special assessment: $\$45{,}000 \div 150 = \$300$ per lot.

12. **Challenge** A buyer says, "I never saw the CC&Rs, so they don't apply to me." Write three sentences explaining why he is wrong and what he should have done.

    Show answer

    Recorded restrictions give constructive notice to every buyer, so he is bound whether or not he read them. Tulk v. Moxhay and American recording law established that a buyer with notice takes subject to the restriction. He should have requested and reviewed the declaration, bylaws, rules and association financial documents before closing.

COMMON MISTAKES

- Thinking the city or county enforces CC&Rs. Private restrictions are enforced by the association and the benefited owners, usually through an injunction.
- Letting zoning override a stricter private covenant. When public and private controls conflict, the more restrictive generally governs.
- Assuming a buyer who never read the recorded restrictions is free of them. Recording gives constructive notice.
- Mixing up the remedies: a covenant is enforced by injunction or damages; a condition by forfeiture of title through re-entry.
- Treating a racially restrictive covenant as merely "unpopular." It is void and unenforceable under *Shelley v. Kraemer* and the Fair Housing Act.
- Forgetting that unpaid association dues and special assessments become a lien on the lot.

Make it a game · Covenant or Condition, Public or Private. The reader calls out a rule and the players race to sort it twice: PUBLIC (zoning, code) or PRIVATE (deed, CC&Rs), and then, if private, COVENANT (injunction) or CONDITION (title returns). Try: a 25-foot setback ordinance; "no boats in driveways" in a declaration; "but if used for a junkyard, title reverts" in a 1920 deed; a fire-code sprinkler rule; an HOA paint-color list; "so long as used for a school." Bonus point for naming who enforces it. Most points after twelve rules wins; the loser recites the conflict rule — the more restrictive governs — three times.

Scripture. "In whose eyes a vile person is contemned; but he honoureth them that fear the LORD. He that sweareth to his own hurt, and changeth not." (Psalm 15:4, KJV)

The psalmist praises the one who keeps his word even when it costs him. Covenants that run with the land are promises made by one owner and inherited by the next, and a neighborhood lives or dies by whether its owners keep them. Honoring a restriction you would rather ignore — or changing it honestly by the agreed vote — is this verse applied to a fence line.

3.4 Property Taxes and Special Assessments

OBJECTIVES

- Define ad valorem taxation and trace market value to assessed value to taxable value through the assessment ratio and exemptions.
- Convert tax rates among mills, dollars per $100, dollars per $1,000, percents and decimals, and compute an annual property tax.
- Explain how a budget-driven tax rate is set and what equalization and assessment appeals do.
- Distinguish a special assessment from the general property tax and apportion one by front footage or share.
- Explain the priority of tax and special-assessment liens and the general pattern of tax sales and redemption.

> **Warm-up.** Your family's property tax statement — or any county's sample statement online — lists several numbers: a market value, an assessed value, a levy or rate, and a tax. Without a calculator, spend five minutes guessing how those numbers connect. Write your guess as a formula. By the end of the lesson you will correct it and be able to compute any tax on the exam.

WATCH

Ace Your Real Estate Exam With Expert Property Tax Math Tips | Just Call Maggie

Just Call Maggie · 9:35

https://www.youtube.com/watch?v=YUp-04Rw27E

> **WHEN TO WATCH**
> Watch after the fourth core idea with your calculator; pause before each answer is revealed and work the problem yourself, especially the mill conversion step.

BACKUP VIDEO

Real Estate Math Video #5 - How To Calculate Real Estate Taxes | Real Estate Exam Prep Videos

The Real Estate Classroom · 7:32

https://www.youtube.com/watch?v=Y8un1yjgfII

A second set of worked tax problems — watch on practice day, pausing each problem to solve it before he does; check your conversions between mills and dollars per $100.

KEY TERMS

ad valorem tax

A tax levied according to value; the general real property tax is ad valorem.

assessed value

The value the assessor places on property for tax purposes, often market value times an assessment ratio set by state law.

market value (for taxation)

The assessor's estimate of the most probable price the property would bring in an open market sale.

assessment ratio

The percentage of market value at which property is assessed, such as 100% or 80% in a given state.

exemption

A reduction in taxable value, or a complete exclusion from tax, allowed by law for certain owners or uses, such as a homestead, a senior or veteran, or a church or school.

mill

One-thousandth of a dollar ($0.001); a tax rate of one mill is $1 of tax per $1,000 of taxable value.

tax levy (tax rate)

The rate a taxing body applies to taxable value, set by dividing the amount it must raise by the total taxable value in its district.

equalization

The adjustment of assessments, often by an equalization factor, so that property in different districts or classes is assessed at the same level.

special assessment

A charge levied only on properties that benefit from a specific public improvement, such as sidewalks, sewers or street paving.

tax lien

A specific, statutory, involuntary lien for unpaid property taxes or special assessments that takes priority over other liens.

tax sale

A public sale of property, or of a lien on it, to collect delinquent taxes, conducted under state law.

redemption

The owner's right to recover property after a tax sale by paying the delinquent taxes, interest and costs within the period state law allows.

CORE IDEAS

The story. In 1696 the government of King William III needed money, and England introduced a tax that seemed easy to collect: houses were taxed by the number of their windows. An assessor could count windows from the street without entering anyone's home, and bigger houses had more of them. But the tax measured windows, not value, and people did what people do — they bricked windows up. Rows of blind windows appeared on English houses, and some buildings were left with whole rooms in darkness. Doctors and sanitary officials blamed the dim, airless rooms for sickness, and critics called it a tax on light and air. After years of complaint Parliament repealed the window tax in 1851. The lesson outlived it: a property tax that measures the wrong thing changes how people build and

live, while a tax that falls on *value* treats similar properties alike and leaves the windows alone.

How they figured it out. American states settled on the **ad valorem** property tax — a tax "according to value." Many state constitutions require taxation to be *uniform*, so equal values bear equal tax. Each county or township elects or appoints an **assessor** who estimates the **market value** of every parcel, usually by mass appraisal of recent sales, and the state sets the **assessment ratio** — the percentage of market value used for tax. Because assessors in different counties may value property at different levels, a state or county board performs **equalization**, raising or lowering assessments by a factor so that each district bears its fair share. An owner who believes an assessment is too high may **appeal** to a local board of review or equalization, with evidence such as recent comparable sales. The rate is set last, from the budget: the taxing bodies decide how much money they need and divide it by the total taxable value.

The big idea. Every property tax follows one chain. Start with **market value**. Multiply by the **assessment ratio** to get **assessed value**. Subtract any **exemptions** to get **taxable value**. Multiply by the **tax rate** to get the **annual tax**. In this example, a house with a market value of $400,000 in a state with an 80% assessment ratio is assessed at $320,000; a $20,000 homestead exemption leaves $300,000 taxable; at 30 mills the tax is $0.030 \times \$300{,}000 = \$9{,}000$. The rate itself is set by budget: in this example a school district must raise $6,000,000 from taxable property worth $400,000,000, so its rate is $\$6{,}000{,}000 / \$400{,}000{,}000 = 0.015$, or 15 mills. A parcel pays the sum of the levies of every district it lies in — county, city, school, fire, library.

Rates come in several dresses, and the exam changes them on purpose. A **mill** is one-thousandth of a dollar, so a rate in mills is dollars per $1,000 of taxable value. To use mills in a calculation, divide by 1,000: 25 mills is 0.025. The same rate is $25 per $1,000, $2.50 per $100, or 2.5%. Practice all four until the conversion is automatic: a rate of $3.20 per $100 is 32 mills and 0.032; 18.5 mills is $1.85 per $100. When a question gives a rate "per $100 of assessed value," divide the value by 100 and multiply by the rate. In this example, a taxable value of $250,000 at $2.40 per $100 pays $2{,}500 \times \$2.40 = \$6{,}000$. Exemptions vary by state — homestead, senior, disabled and veteran exemptions are common examples, and government, school

and religious property is often exempt entirely — so check your county for the live figures.

A **special assessment** is different from the general property tax in purpose and reach. It pays for a specific local improvement — a sidewalk, a sewer line, curbs, streetlights, street paving — and is charged only to the properties that the improvement benefits, usually inside a local improvement district. It is not ad valorem: it is commonly apportioned by **front footage** (the feet of a lot along the street), by lot, or by estimated benefit. In this example, a sidewalk costing $180,000 is spread over 3,600 front feet, or $50 per front foot; a lot with 75 feet of frontage owes $75 \times \$50 = \$3{,}750$. Special assessments are often payable in installments over several years, and the unpaid balance is a lien on the land. That makes them a disclosure item: buyers and sellers must agree who pays the remaining installments, and the title report should show any assessment lien.

Taxes are collected by lien. Unpaid real property taxes and special assessments become **specific**, **statutory**, **involuntary** liens on the parcel, and they take **priority** over other liens — even a mortgage recorded years earlier. That is why lenders often collect taxes monthly through an **escrow (impound) account** and why title companies check tax status before closing. If taxes stay delinquent, state law provides a **tax sale**. In one common pattern the county sells a **tax lien certificate**; the owner may **redeem** by paying the taxes, interest and costs, and if no redemption occurs within the statutory period, the certificate holder may obtain a tax deed. In another pattern the county sells the property itself by **tax deed**, sometimes with a redemption period afterward. Details differ widely by state, so learn the pattern and check your state. Note too that taxes may be paid in arrears or in advance, which matters for closing prorations in Lesson 6.5.

On the exam today. Expect one or two calculations and a recall item. The calculation is the chain — market value times assessment ratio, minus exemptions, times the rate — usually with the rate in mills or per $100. Convert first: mills divided by 1,000 is the decimal. Know how a rate is set (amount needed ÷ total taxable value), that ad valorem means by value, and that a special assessment falls only on benefited property. The traps: applying the rate to market value when the question gives an assessment ratio; applying mills as a percent (30 mills is 3%, not 30%); forgetting to subtract an exemption before applying the rate, or subtracting it from market value instead of assessed value when the question says otherwise; thinking a special

assessment is a general tax on everyone; and thinking a mortgage recorded first outranks a tax lien — real property tax and special-assessment liens come first. Expect “specific, statutory, involuntary” as the description of a tax lien.

PICTURE STUDY



The Tax-Collector's Office, Pieter Brueghel the Younger, c. 1615 · Oil on panel · Art Gallery of South Australia, Adelaide

Image: Wikimedia Commons, public domain

Pieter Brueghel the Younger was the son of the great Flemish painter Pieter Bruegel the Elder, and he ran a busy Antwerp workshop that painted village life in many versions. Scenes like this one — sometimes called "Paying the Tithes" or "The Village Lawyer" — show country people bringing what they owed, in coin and in kind, to an official buried in records. The painting opens this lesson because property taxes have always been two things at once: a duty owed by every landholder, and a mountain of records that must be kept honestly for the duty to be fair.

Look closely

- Look at the walls and rafters. Every hanging sack is full of papers — the assessments, receipts and accounts on which the whole system depends.
- Find the payments in kind: eggs, a hen, small bundles. Before money was common in villages, taxes and rents were often paid in produce.
- Watch the faces and the hats in hand. Brueghel shows patience, worry and a little humor, not anger.
- Find the clerk writing at the side table. Recording each payment is what lets an owner prove later that the tax was paid.

Talk about it

1. Which of today's documents would the papers in this office correspond to — the assessment roll, the tax statement, the receipt?
2. Why might paying a tax in eggs and hens be harder to keep fair than a tax figured as a rate on assessed value?
3. Romans 13:7 tells us to render "tribute to whom tribute is due." What does honest dealing look like on both sides of this table — for the payer and for the collector?

PROJECT

Read a Real Tax Statement

You will take apart one real property tax statement from your county — your family's, with their permission, or a sample posted by the treasurer — and rebuild the tax from scratch. Then you will compute taxes and a special assessment for a pretend property. Do not copy any owner's name or account number into your notebook.

You will need

- A county property tax statement or the county's online sample statement
- Your county assessor's and treasurer's websites
- A calculator and your exam notebook
- Free spreadsheet software (optional)

Steps

1. Find and copy the statement's market value, assessed value, any exemptions and the taxable value. Write the assessment ratio your state uses if the statement or assessor site gives it.
2. List every taxing district that levies on the parcel (county, city, school, fire, library...) and its rate. Add them to a total rate.
3. Convert the total rate to mills, dollars per $100 and a decimal.
4. Recompute the tax: taxable value times the decimal rate. Compare your answer with the statement and explain any difference.
5. Find on the assessor's site how an owner appeals an assessment and the deadline for doing so.
6. Pretend property: market value $425,000, assessment ratio 100%, exemption $0, rate 24.5 mills; then add a $4,200 special assessment payable over 7 years. Compute the annual tax and the yearly principal installment.
7. Title the page "How a Tax Bill Is Built," date it, and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, plus a conversion card: 1 mill = $0.001 = $1 per $1,000 = $0.10 per $100 = 0.1%.
2. Draw the property-tax chain as a flowchart: MARKET VALUE → × ratio → ASSESSED VALUE → − exemptions → TAXABLE VALUE → × rate → TAX.
3. Write a five-line trap list titled "Property tax," ending with: tax and special-assessment liens come FIRST, ahead of an earlier mortgage.

KEY FORMULAS

$$\text{Assessed value} = \text{market value} \times \text{assessment ratio}$$

$$\text{Taxable value} = \text{assessed value} - \text{exemptions}$$

$$\text{Annual tax} = \text{taxable value} \times \text{tax rate}$$

$$1 \text{ mill} = \$0.001 = \$1 \text{ per } \$1{,}000; \quad \text{decimal rate} = \frac{\text{mills}}{1{,}000}$$

$$\text{Tax rate} = \frac{\text{amount to be raised}}{\text{total taxable value}}$$

$$\text{Special assessment share} = \text{front feet} \times \frac{\text{total cost}}{\text{total front feet}}$$

From history. The word mill on your tax bill comes from the founding of American money. The Coinage Act of 1792 declared that the accounts of the United States would be kept in dollars, "dismes" or tenths, cents or hundredths, and "milles" or thousandths. The dime and the cent became coins; the mill never did. It survived as a unit of account — and its one great home today is the property tax rate, where a mill still means a thousandth of a dollar.

WORKED EXAMPLES

Example 1. In this example, a home has a market value of $350,000. The state assesses at 90% of market value, the owner qualifies for a $15,000 homestead exemption from assessed value, and the combined rate is 28 mills. Compute the annual tax and the monthly amount a lender would escrow.

Show solution

1. Assessed value: $\$350{,}000 \times 0.90 = \$315{,}000$.
2. Taxable value: $\$315{,}000 - \$15{,}000 = \$300{,}000$.
3. Convert the rate: $28 \text{ mills} \div 1{,}000 = 0.028$.
4. Annual tax: $\$300{,}000 \times 0.028 = \$8{,}400$.
5. Monthly escrow: $\$8{,}400 \div 12 = \$700$.

Answer: The annual tax is $8,400; the lender would escrow about $700 a month.

Example 2. Exam style. In this example, a county must raise $7,200,000 in property taxes. The total taxable value in the county is $480,000,000. What is the tax rate?

A. 1.5 mills

B. 15 mills

C. $15.00 per $100

D. 0.15%

Show solution

1. Rate = amount needed ÷ total taxable value: $\$7{,}200{,}000 \div \$480{,}000{,}000 = 0.015$.
2. As mills: $0.015 \times 1{,}000 = 15$ mills.
3. Check the others: 0.015 is $1.50 per $100 (not $15) and 1.5% (not 0.15%).

Answer: B. 15 mills — that is $15 per $1,000, $1.50 per $100 and 1.5%.

Example 3. In this example, a new sewer line costs $264,000 and is charged to the benefited lots on both sides of a street with a total of 4,400 front feet. A corner lot has 80 feet of frontage on this street. The assessment may be paid over 10 years in equal annual principal installments. What is the lot's assessment and its first-year principal installment?

Show solution

1. Cost per front foot: $\$264{,}000 \div 4{,}400 = \$60$.
2. The lot's share: $80 \times \$60 = \$4{,}800$.
3. Annual principal installment: $\$4{,}800 \div 10 = \$480$ (interest on the unpaid balance is usually added).
4. Until paid, the balance is a lien with priority, so a sale contract should say who pays the remaining installments.

Answer: The assessment is $4,800, or $480 of principal per year for ten years.

PRACTICE

1. Easy What does ad valorem mean, and which tax on real estate is ad valorem?

   Show answer

   "According to value." The general real property tax is ad valorem; special assessments are not, because they are based on benefit, frontage or lots.

2. Easy Convert 22 mills to a decimal, to dollars per $1,000 and to dollars per $100.

   Show answer

   0.022; $22 per $1,000; $2.20 per $100.

3. Easy Who places a value on property for tax purposes, and what may an owner do who thinks it is too high?

   Show answer

   The assessor. The owner may appeal to the local board of review or equalization, usually with evidence such as recent comparable sales, before the deadline.

4. **Medium** In this example, a property has a taxable value of $280,000 and a rate of 31 mills. What is the annual tax?

   Show answer

   $280,000 \times 0.031 = $8,680.

5. **Medium** In this example, market value $500,000, assessment ratio 60%, veteran exemption $10,000 (from assessed value), rate $3.00 per $100. Find the tax.

   Show answer

   Assessed: $300,000. Taxable: $290,000. Tax: $2{,}900 \times $3.00 = $8,700.

6. **Medium** A city's taxing district must raise $2,250,000 from total taxable value of $125,000,000. Find the rate in mills.

   Show answer

   $2,250,000 \div $125,000,000 = 0.018, or 18 mills.

7. **Medium** A homeowner's mortgage was recorded in 2015. In 2024 the owner stops paying property taxes. Which lien has priority?

   Show answer

   The property tax lien. Real property tax and special-assessment liens take priority over other liens, including an earlier-recorded mortgage.

8. **Hard** In this example, a street-paving project costing $96,000 is assessed at $40 per front foot. How many total front feet are in the district, and what does a 65-foot lot owe?

   Show answer

   Total front feet: $96,000 \div $40 = 2{,}400. The 65-foot lot owes $65 \times $40 = $2,600.

9. **Hard** An owner's tax rose 12% although the county's rate stayed the same. Give two possible reasons.

   Show answer

   Her assessed value rose — through reassessment or an equalization factor — or an exemption she had was removed or reduced. With the rate unchanged, only taxable value can move the bill.

10. Hard Describe the general pattern of a tax lien certificate sale and redemption.

Show answer

The county sells a certificate for the delinquent taxes to an investor; the owner may redeem by paying the taxes, interest and costs within the statutory period; if no one redeems, the certificate holder may apply for a tax deed. Details differ by state.

11. Challenge In this example, an owner's taxable value is $360,000 and her annual tax is $9,360. What is the rate in mills and per $100? If an equalization factor of 1.05 is applied next year at the same rate, what will the tax be?

Show answer

Rate: $\$9{,}360 \div \$360{,}000 = 0.026$ = 26 mills = $2.60 per $100. Next year: $\$360{,}000 \times 1.05 = \$378{,}000$; tax $\$378{,}000 \times 0.026 = \$9{,}828$.

12. Challenge Explain in three sentences why a value-based tax is fairer than the old English window tax, using the words ad valorem, uniform and equalization.

Show answer

An ad valorem tax falls on what a property is worth, so similar properties bear similar taxes no matter how many windows or rooms they have. State uniformity rules require equal values to be taxed alike, and equalization corrects districts whose assessors valued property too high or too low. The window tax measured a feature instead of value, so it punished light and air and taught people to wall up their homes.

COMMON MISTAKES

- Applying the tax rate to market value when the question gives an assessment ratio. Multiply market value by the ratio first, subtract exemptions, then apply the rate.
- Treating mills as a percent. Thirty mills is 0.030, or 3% — not 30%. Divide mills by 1,000.
- Confusing "per $100" with "per $1,000." A rate of $2.50 per $100 is $25 per $1,000, or 25 mills.
- Thinking a special assessment is a general tax on everyone. It falls only on the properties that benefit from the improvement.

- Believing an earlier-recorded mortgage outranks a property tax lien. Real property tax and special-assessment liens come first.
- Forgetting the rate is set from the budget: amount to be raised divided by total taxable value.

Make it a game · Mill Race. Write twelve cards, each with a taxable value and a rate in a different dress: mills, dollars per $100, dollars per $1,000 or percent (for example, $240,000 at 27 mills; $180,000 at $3.10 per $100). Deal one card face up; the first player to call the correct annual tax keeps it. A wrong answer passes the turn. Add two special-assessment cards with front footage and a cost per foot. The player with the most cards when the deck runs out wins, and the last-place player converts 18.5 mills into the other three dresses aloud.

Scripture. “Render therefore to all their dues: tribute to whom tribute is due; custom to whom custom; fear to whom fear; honour to whom honour.” (Romans 13:7, KJV)

Paul teaches believers to pay what they owe to civil government, and property tax is the most direct tribute a landholder pays. The ad valorem system’s ideals — uniform values, honest assessments, a right of appeal — make that duty just on both sides. A licensee who explains a tax bill accurately and discloses a pending special assessment honestly helps everyone render exactly what is due.

3.5 Environmental Hazards and the Law

OBJECTIVES

- Identify the common environmental hazards in and around real property — lead-based paint, asbestos, radon, mold, underground storage tanks, contaminated groundwater and waste sites — and the warning signs of each.
- State the requirements of the federal lead-based paint disclosure rule for housing built before 1978 and the licensee's duty to ensure compliance.
- Explain CERCLA liability (strict, joint and several, retroactive), potentially responsible parties, SARA's innocent landowner defense, and Phase I and II environmental site assessments.
- Describe the roles of the EPA, the Clean Air and Clean Water Acts, and Section 404 wetlands permits.
- Read a FEMA flood zone designation and state when federal law requires flood insurance on a loan.

> **Warm-up.** List five things in or under a house that you cannot see on a showing but that a buyer would want to know about. Next to each, write how someone could find out. In five minutes you will have most of this lesson's outline — and you will notice that almost none of these hazards announce themselves.

WATCH

Real Estate and Environmental Issues | Real Estate Exam

The Real Estate Classroom · 16:11

https://www.youtube.com/watch?v=QpKV_Q0tXiY

> **WHEN TO WATCH**
> Watch after the fifth core idea; make a two-column list — hazard, and the test or professional who finds it — and add lead, CERCLA and flood zones from the reading afterward.

BACKUP VIDEO

The National Flood Insurance Program

FEMA · 3:34

https://www.youtube.com/watch?v=fGYIblbHJQM

FEMA's own short explanation of the National Flood Insurance Program — watch before the project, and note what a community must do to qualify and why mapped flood zones matter to a lender.

KEY TERMS

lead-based paint disclosure rule

The federal rule requiring sellers and landlords of most housing built before 1978 to disclose known lead-based paint and hazards, give the EPA pamphlet and, for buyers, a 10-day opportunity to test.

asbestos

A fibrous mineral once used in insulation, flooring and siding; dangerous when friable (crumbling) and its fibers become airborne; managed by encapsulation or licensed removal.

radon

A colorless, odorless radioactive gas from the natural decay of uranium in soil and rock that can collect in buildings; the EPA recommends fixing homes at 4 picocuries per liter (pCi/L) or more.

underground storage tank (UST)

A tank, with its piping, at least 10% of whose volume is underground, used to store petroleum or hazardous substances; leaks can contaminate soil and groundwater.

brownfield

Abandoned or underused industrial or commercial property whose redevelopment is complicated by real or suspected contamination.

CERCLA (Superfund)

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980, which funds cleanup of hazardous waste sites and makes responsible parties pay.

potentially responsible party (PRP)

Under CERCLA, a current or past owner or operator, a generator who arranged for disposal, or a transporter who may be liable for cleanup costs.

strict, joint and several, retroactive liability

CERCLA's liability standard: no proof of fault is needed, any one PRP may be made to pay the whole cost, and it applies to disposal that occurred before the law was passed.

innocent landowner defense

A defense added by SARA (1986) for an owner who made all appropriate inquiry before buying and did not know, and had no reason to know, of the contamination.

Phase I environmental site assessment

An investigation of a property's history and condition through records, site inspection and interviews, without sampling, to identify recognized environmental conditions.

wetlands

Land saturated with water often enough to support water-loving plants; filling them generally requires a permit under Section 404 of the Clean Water Act.

special flood hazard area (SFHA)

Land FEMA maps as having a 1% or greater chance of flooding in any year (the "100-year floodplain"), shown as zones beginning with A or V.

CORE IDEAS

The story. Around the turn of the twentieth century, a developer named William T. Love began digging a canal near Niagara Falls, New York, to carry river water to power a planned industrial city. The money ran out, and the half-dug trench was abandoned. From 1942 to the early 1950s, a chemical company used the old canal as a dump, burying an estimated 21,000 tons of chemical waste in drums and covering it with clay. In 1953 it sold the land to the local school board for one dollar, with a

deed clause stating that the land held chemical waste and disclaiming the company's responsibility. A school opened on the site in the mid-1950s, and homes were built along the canal's banks. By the 1970s chemicals were seeping into yards and basements. In August 1978 the state declared a health emergency and the federal government declared an emergency at Love Canal; in the end more than 800 families were relocated. The question everyone asked was the one this lesson answers: who pays to clean up land poisoned long ago?

How they figured it out. Congress answered on December 11, 1980, with the **Comprehensive Environmental Response, Compensation, and Liability Act — CERCLA**, known as **Superfund**. It created a federal fund for cleaning up hazardous waste sites, with the worst listed on the National Priorities List, and it made **potentially responsible parties** repay the cost: the current owner or operator, owners or operators at the time of disposal, the generators who arranged disposal, and the transporters who hauled it. Liability is **strict** (no fault required), **joint and several** (any one PRP can be made to pay the whole bill) and **retroactive** (it reaches disposal before 1980). Love Canal's deed disclaimer taught the lesson: private parties may divide costs among themselves by contract, but no deed clause shields an owner from the government. The **Superfund Amendments and Reauthorization Act** (**SARA**) of 1986 added the **innocent landowner defense** for buyers who investigate first.

The big idea. An environmental hazard is a **material fact**: something a reasonable buyer would want to know because it affects value, health or the cost of ownership. Hazards fall into three groups. *In the building*: lead-based paint, asbestos, radon, mold and carbon monoxide from faulty appliances. *In the ground*: leaking underground storage tanks, contaminated groundwater and wells, buried waste and old industrial sites. *On the land*: wetlands and flood plains. A licensee is not an inspector, chemist or engineer and must not act like one. The licensee's duties are to disclose known hazards, to recognize warning signs — an old fill pipe in the yard, a basement with water stains, peeling paint in a 1950s house, a former gas station next door — and to recommend that buyers obtain qualified inspections and tests. The federal agency behind most of these rules is the **Environmental Protection Agency** (EPA), created in 1970; states add their own disclosure forms and rules.

Lead-based paint is the hazard with the most specific federal rule. Lead paint was banned for residential use in 1978, so the rule covers most housing built **before 1978.**

Under the **Residential Lead-Based Paint Hazard Reduction Act** of 1992 and the EPA–HUD disclosure rule it produced, a seller or landlord must disclose known lead-based paint and hazards and provide any reports; give the buyer or tenant the EPA pamphlet *Protect Your Family From Lead in Your Home*; include the **Lead Warning Statement** in the contract or lease; give buyers a **10-day opportunity** to test (which buyer and seller may change or waive in writing); and keep the signed disclosure for **3 years**. Agents for the seller or landlord must make sure the rule is followed and share liability if it is not. Tenants receive the disclosures but not the 10-day testing right. **Asbestos**, common in insulation, flooring and siding before the 1980s, is dangerous mainly when **friable**; it is often managed in place by **encapsulation**, and removal calls for licensed professionals.

Radon is a radioactive gas from natural uranium in soil; it enters through foundations and is the leading cause of lung cancer among nonsmokers. Only a test reveals it. The EPA recommends fixing a home at **4 picocuries per liter** (pCi/L) or more, commonly with sub-slab depressurization — a vent pipe and fan. **Mold** follows moisture; there is no federal mold standard, so the cure is fixing the water source and removing the growth. **Underground storage tanks** hold heating oil or fuel; leaks can foul soil and **groundwater**, and commercial tanks are regulated by the EPA and states. Abandoned gas stations and factories become **brownfields** that federal and state programs help clean up and reuse. For commercial property, lenders and buyers order a **Phase I environmental site assessment** — records, site visit and interviews, no sampling; if it finds a recognized environmental condition, a **Phase II** takes soil and water samples, and cleanup follows. A Phase I meeting federal standards is how a buyer makes the "all appropriate inquiry" the innocent landowner defense requires.

Water and air have their own statutes. The **Clean Air Act** regulates air pollution from factories and vehicles, and EPA rules under it govern asbestos removal. The **Clean Water Act** of 1972 regulates discharges into the nation's waters; under **Section 404**, filling or dredging **wetlands** generally requires a permit from the U.S. Army Corps of Engineers, with EPA oversight. A buyer who fills a marshy corner of a lot without a permit can face fines and an order to restore it, so "wet" land is a red flag. Flooding is the most common natural hazard. **FEMA** publishes Flood Insurance Rate Maps. A **special flood hazard area** has a 1% or greater chance of flooding each year; its zones begin with **A** (such as AE) or, on coasts with wave action, **V**. Zone **X** marks moderate

or minimal risk. Under the **National Flood Insurance Program** (1968) and the Flood Disaster Protection Act of 1973, a loan from a federally regulated or insured lender, or backed by a federal agency, on a building in a special flood hazard area requires flood insurance. Standard homeowners policies exclude flood.

On the exam today. Expect three to five questions; this is a heavily tested topic. Lead: 1978 is the cutoff year; buyers get a 10-day testing opportunity, tenants do not; the pamphlet, warning statement and 3-year record keeping are required; the seller's agent shares responsibility. Radon: a gas from the soil, found only by testing, action level 4 pCi/L. Asbestos: dangerous when friable; encapsulation is acceptable. CERCLA: strict, joint and several, retroactive; the current owner can be liable for contamination someone else caused; the innocent landowner defense (SARA, 1986) requires all appropriate inquiry — a Phase I — *before* purchase. Flood: zones A and V are high risk, insurance is required on federally related loans there, and homeowners policies exclude flood. The traps: thinking "as is" or a deed disclaimer escapes CERCLA; thinking a Phase I includes sampling (that is Phase II); thinking tenants get the 10-day test; thinking a licensee should test, diagnose or remove hazards (disclose and refer); and confusing Zone X with high risk.

PICTURE STUDY



Niagara, Frederic Edwin Church, 1857 · Oil on canvas · National Gallery of Art, Washington, D.C.
Image: Wikimedia Commons, public domain

Frederic Edwin Church was the most celebrated American landscape painter of the 1850s, a student of Thomas Cole and a member of the Hudson River School. When he showed this canvas in 1857, crowds lined up to see it; viewers marveled that it seemed to set them at the very brink, with no rock or shore between them and the water. It opens this lesson because the same river that Church painted as a wonder of creation drew industry to Niagara Falls — and with industry came the canal, the chemical dump and, at last, the laws that teach us to keep land and water clean for those who come after.

Look closely

- Find the horizon. Church left out any foreground ledge, so the viewer seems to float above the rapids — a bold choice that made the painting famous.
- Look for the rainbow in the mist. Church studied light and weather closely; the faint arc is drawn exactly where sunlight would bend through the spray.
- Find the broken branch in the rapids at the lower left. It gives scale — and a hint of how powerful and indifferent moving water is.
- Notice that no factory, mill or bridge appears, though the area already had them in 1857. Church chose to paint the river as untouched land.

Talk about it

1. Church painted Niagara as untouched; a century later Love Canal stood a few miles away. What changed, and what did the law learn from it?
2. Which of today's statutes — CERCLA, the Clean Water Act, the flood insurance program — would matter most to someone buying riverside land near these falls? Why?
3. Genesis 2:15 says man was placed in the garden "to dress it and to keep it." What does it mean for an owner, a seller or a licensee to "keep" the land entrusted to them?

PROJECT

The Environmental Due-Diligence Checklist

You will build the one-page environmental checklist a careful licensee keeps in every listing file, then use public federal and county tools to research a pretend purchase. Use only public sites and invent the property details where needed.

You will need

- EPA's lead disclosure and radon pages and the "Search for Superfund Sites Where You Live" tool
- FEMA's Flood Map Service Center (msc.fema.gov)
- Your state's seller disclosure form, if posted by the real estate commission
- Your exam notebook and a calculator

Steps

1. Divide a page into three columns — In the building, In the ground, On the land — and list every hazard from this lesson in its column.
2. Beside each hazard, write one warning sign a licensee might notice and the professional or test that confirms it (lead inspector, radon test, Phase I, survey, wetland delineation).
3. Add a box for the lead rule with its five requirements: disclosure and reports, pamphlet, warning statement, 10-day test opportunity, 3-year record keeping.
4. Search the FEMA Flood Map Service Center for a public address in your town (a library or school). Record its flood zone and write whether a federally backed loan there would require flood insurance.
5. Use the EPA Superfund search for your county and list the nearest site and its status in one line.
6. Look up your state's seller disclosure form and list which environmental questions it asks.

7. Title the page “Environmental Due Diligence,” date it, and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, plus number cards: 1978 (lead cutoff), 10 days (buyer test), 3 years (records), 4 pCi/L (radon), 1980 (CERCLA), 1986 (SARA), 1% (special flood hazard area).
2. Draw a three-column chart — IN THE BUILDING, IN THE GROUND, ON THE LAND — with each hazard, its warning sign and how it is confirmed.
3. Write a five-line trap list titled “Environmental,” ending with: a licensee DISCLOSES and REFERS — never tests, diagnoses or removes.

> **From history.** On June 22, 1969, an oil slick and debris on Cleveland’s Cuyahoga River caught fire under a railroad bridge. It was not the river’s first fire, and it was put out in about half an hour, but national magazine coverage made it a symbol of polluted waters. The Environmental Protection Agency was organized the next year, in December 1970, and Congress passed the Clean Water Act in 1972 — the law whose Section 404 still governs every wetland permit.

Example 1. A seller lists a house built in 1962. The listing agent knows a prior inspection found lead-based paint on the exterior trim. Walk through what federal law requires before a buyer is bound by the contract.

Show solution

1. Built before 1978, so the lead-based paint disclosure rule applies (no exemption fits a typical single-family sale).
2. The seller must disclose the known lead-based paint and give the buyer the prior inspection report.
3. The buyer must receive the EPA pamphlet *Protect Your Family From Lead in Your Home*.
4. The contract must include the Lead Warning Statement and the disclosure signed by the parties, and the buyer must be offered a 10-day opportunity to test (which the buyer may waive in writing).
5. The seller and agent keep the signed disclosure for 3 years. The agent shares liability for compliance.

Answer: Disclosure of the known paint and the report, the pamphlet, the warning statement, a 10-day testing opportunity, and 3 years of records — with the listing agent responsible for seeing it done.

Example 2. A buyer purchases an old industrial lot without any environmental investigation. A year later, the state finds solvents in the groundwater, dumped by a factory that operated there in the 1960s and has since dissolved. Is the buyer liable under CERCLA, and could he have protected himself?

Show solution

1. CERCLA makes the **current owner** a potentially responsible party, regardless of who caused the contamination.
2. Liability is strict (no fault needed), joint and several (he can be made to pay all of it) and retroactive (the 1960s disposal counts).
3. The innocent landowner defense requires all appropriate inquiry BEFORE purchase — in practice a Phase I site assessment — and no knowledge or reason to know.
4. He made no inquiry, so the defense is unavailable. A Phase I (and a Phase II if it flagged the factory history) would have revealed the risk or preserved the defense.

Answer: Yes, he is likely liable as the current owner. A Phase I environmental site assessment before closing was his protection.

Example 3. Exam style. A buyer is financing a house with an FHA-insured loan. FEMA's map shows the house in Zone AE. Which statement is correct?

A. Flood insurance is optional because the buyer has a homeowners policy

B. Flood insurance is required because the building is in a special flood hazard area and the loan is federally backed

C. Flood insurance is required only if the house has flooded before

D. Flood insurance is required only in Zone X

Show solution

1. Zones beginning with A or V are special flood hazard areas — at least a 1% annual chance of flooding.
2. An FHA-insured loan is federally backed.
3. Federal law requires flood insurance on a building in a special flood hazard area securing such a loan.
4. A homeowners policy excludes flood, so A fails; Zone X is moderate or minimal risk, so D is backward.

Answer: B. Zone AE plus a federally backed loan means flood insurance is required.

PRACTICE

1. Easy Which homes are covered by the federal lead-based paint disclosure rule?

   Show answer

   Most housing built before 1978, the year lead-based paint was banned for residential use; certain exemptions exist, such as housing with no bedrooms and some housing for the elderly.

2. Easy What is radon, and how is it detected?

   Show answer

   A colorless, odorless radioactive gas from the natural decay of uranium in soil and rock. Only a radon test detects it; the EPA recommends fixing homes at 4 pCi/L or more.

3. Easy What does a Phase I environmental site assessment include, and what does it not include?

Show answer

Records review, a site inspection and interviews to identify recognized environmental conditions. It does not include soil or water sampling — that is a Phase II.

4. Medium A landlord rents a 1955 house to a family. Which lead-paint requirements apply, and which buyer right does not?

Show answer

The landlord must disclose known lead-based paint and hazards, provide reports, give the EPA pamphlet and include the warning statement in the lease, keeping records 3 years. Tenants do not get the 10-day testing opportunity that buyers receive.

5. Medium Explain strict, joint and several, and retroactive as they apply to CERCLA.

Show answer

Strict: no proof of fault is required. Joint and several: any one potentially responsible party can be made to pay the entire cleanup cost. Retroactive: it applies to disposal that occurred before CERCLA was enacted in 1980.

6. Medium A home inspector finds wrapped pipe insulation in a 1940s basement that is intact and not crumbling. What should the licensee advise?

Show answer

Recommend evaluation by a qualified asbestos professional. Intact (non-friable) asbestos is often safely managed in place by encapsulation; the danger rises when it crumbles and fibers become airborne. The licensee should disclose, not diagnose or disturb it.

7. Medium A buyer wants to fill a marshy low spot on a rural lot to build a shop. What federal law may require a permit, and from whom?

Show answer

Section 404 of the Clean Water Act, if the area is a regulated wetland; the permit comes from the U.S. Army Corps of Engineers, with EPA oversight.

8. Hard A house is in FEMA Zone X and the buyer has a conventional loan. Is flood insurance federally required? Should the buyer consider it?

Show answer

Not federally required, because Zone X is outside the special flood hazard area. It is still available, and many floods occur outside high-risk zones, so a buyer may reasonably consider it; homeowners policies exclude flood.

9. Hard What did SARA (1986) add to CERCLA, and what must a buyer do to use it?

Show answer

The innocent landowner defense. The buyer must have made all appropriate inquiry into the property's past uses and condition before buying — in practice a Phase I meeting federal standards — and must not have known or had reason to know of the contamination.

10. Hard A seller says, "I'm selling as is, so I don't have to say anything about the old heating-oil tank I know is buried in the yard." Is he right?

Show answer

No. An "as is" sale does not permit concealing a known material fact, and most states require disclosure of known defects; the federal lead rule and state forms add specific duties. A buried tank that may leak is a material fact the seller and his agent must disclose.

11. Challenge A chemical company sold land with a deed clause disclaiming liability for buried waste, as at Love Canal. Under CERCLA, does the clause protect the company from the government? Does it matter between the buyer and seller?

Show answer

It does not protect the company from the government: CERCLA liability cannot be contracted away as against the United States, and the company remains a potentially responsible party. Between the private parties, an indemnity or allocation clause may decide who reimburses whom.

12. **Challenge** Write three sentences a listing agent could say to a buyer of a 1970 house about environmental issues, without giving expert advice.

Show answer

Because the house was built before 1978, you will receive the lead-based paint disclosure and pamphlet and have a 10-day opportunity to test. I recommend a home inspection and a radon test, and the seller's disclosure lists what the seller knows. I am not an environmental expert, so I will refer you to licensed inspectors for anything that needs testing or evaluation.

COMMON MISTAKES

- Using the wrong lead-paint cutoff year. The rule covers most housing built BEFORE 1978.
- Giving tenants the 10-day testing opportunity. Only buyers receive it; tenants receive the disclosure, pamphlet and warning statement.
- Thinking a Phase I assessment includes sampling. Phase I is records, site visit and interviews; Phase II samples soil and water.
- Believing an "as is" sale or a deed disclaimer shields an owner from CERCLA. The current owner can be liable for contamination others caused.
- Treating Zone X as high risk. High-risk special flood hazard areas are zones beginning with A or V.
- Testing, diagnosing or removing hazards as a licensee. The licensee discloses known facts and refers buyers to qualified professionals.

> **Make it a game · Hazard Detective.** One player is the inspector and secretly picks a hazard card: lead paint, asbestos, radon, mold, buried oil tank, contaminated well, wetland, flood zone, old gas station next door. The others ask yes-or-no questions only (Is it a gas? Does a 1978 date matter? Would a Phase I find it?). Guess within ten questions to win the card; the winner must then name the test or professional who confirms it and one law that applies. After each round, the guesser who used the fewest questions becomes the next inspector.

> **Scripture.** “And the LORD God took the man, and put him into the garden of Eden to dress it and to keep it.” (Genesis 2:15, KJV)
>
> From the beginning, man was given land both to work and to guard. The environmental laws in this lesson are, at their best, rules for keeping land fit for the next owner — the family who will raise children in the house, drink the well water and build on the lot. A licensee who discloses what he knows and recommends honest testing is helping one more owner dress and keep the ground entrusted to him.

UNIT 3

Land Use, Taxes and the Environment

In 1926 a real estate company in a small Ohio village told the Supreme Court it had lost three-quarters of its land's value — not to a fire or a flood, but to a new law that said most of its acres could hold houses and not factories. The Supreme Court said the village was within its rights. This unit is about the limits that surround every parcel of private land, however firmly owned. You will begin with the four powers that every government holds over land — the **police power**, **eminent domain**, **taxation** and **escheat** — and learn exactly when the government must pay and when it need not. You will study **zoning** from *Euclid v. Ambler* to the **variance**, the **conditional use permit** and the **nonconforming use**, and the private rules neighbors make for one another through **deed restrictions**, **CC&Rs** and owners' associations.

Then you will follow the money and the ground itself. You will build a property tax from market value to **assessed value** to the bill, convert rates among **mills** and dollars per hundred, and apportion a **special assessment** by the front foot. Last, you will learn the hazards a buyer cannot see — lead-based paint, asbestos, radon, buried tanks, contaminated ground and the flood plain — and the federal laws, from **CERCLA** to the flood insurance program, that decide who must disclose, who must test and who must pay. Keep your calculator nearby for Lesson 3.4, and keep your conscience nearby throughout: most of this unit is about telling the truth about land.

PREREQUISITES

- Can explain fee simple ownership and the bundle of rights from Unit 2, and why even full ownership has limits
- Can tell a lien from an easement and a voluntary lien from an involuntary one (Lesson 2.5)
- Can compute percents, convert between decimals and percents, and find area in square feet and acres (43,560 square feet per acre)
- Has the exam notebook current, with the Unit 2 vocabulary of estates, encumbrances and recording ready for review

MASTERY CHECKLIST

- ☐ I can name the four powers of government (PETE), classify any government action under the right one, and say when compensation is owed.
- ☐ I can compute just compensation for a partial taking and separate it into the value of the part taken and severance damages.
- ☐ I can explain *Euclid v. Amb ler* and choose correctly among a variance, a conditional use permit, a nonconforming use, a rezoning and illegal spot zoning.
- ☐ I can compute a buildable footprint from setbacks and check lot coverage and floor-area ratio.
- ☐ I can distinguish deed restrictions from CC&Rs and a covenant from a condition, name the ways restrictions end, and apply the more-restrictive-governs rule.
- ☐ I can compute a property tax from market value, assessment ratio, exemptions and a rate in mills or per $100, and set a rate from a budget.
- ☐ I can apportion a special assessment and explain why tax and special-assessment liens take priority over an earlier mortgage.

- ☐ I can state the lead-based paint disclosure requirements, CERCLA's liability rules and the innocent landowner defense, and when flood insurance is required.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **EPA: Real Estate Disclosures About Potential Lead Hazards**: Free, official. The EPA's own page on the lead-based paint disclosure rule for sellers, landlords and agents, with the required pamphlet and sample disclosure forms. Use it with Lesson 3.5 and its project. Ages 15 and up.
- **EPA: Radon**: Free, official. What radon is, how homes are tested and fixed, the 4 pCi/L action level and a radon zone map by county. Read it with Lesson 3.5 and look up your own county. Ages 14 and up.
- **FEMA Flood Map Service Center**: Free, official. Search any address to see its flood zone on FEMA's Flood Insurance Rate Maps. Use it in the Lesson 3.5 project to tell a Zone AE from a Zone X. Ages 14 and up.
- **EPA: Search for Superfund Sites Where You Live**: Free, official. A map and search tool for Superfund sites by state and county, with each site's history and cleanup status. Use it with Lesson 3.5 to see CERCLA at work near home. Ages 15 and up.
- **Oyez: Village of Euclid v. Ambler Realty Co. (1926)**: Free. A plain summary of the zoning case, with the question presented and the holding, from a free academic project on the Supreme Court. Read it with Lesson 3.2 before the game. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

3.1 The Four Powers of Government — 3 sessions of 50 minutes

3.2 Zoning and Planning: Euclid v. Ambler — 3 sessions of 50 minutes

3.3 Private Controls: Deed Restrictions, CC&Rs and Owners' Associations

3 sessions of 50 minutes

3.4 Property Taxes and Special Assessments — 3 sessions of 50 minutes

Unit 3 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Seventy percent (14 of 20) matches the common passing line, but aim higher. Figures marked “in this example” are examples — real tax rates, assessment ratios and exemptions vary by state and county. Choose the one BEST answer.

1. **5 pts**

   A city adopts an ordinance dividing its land into residential, commercial and industrial districts. This is an exercise of:

   A. Eminent domain

   B. Police power

   C. Escheat

   D. Taxation

2. **5 pts**

   When a government takes private property by eminent domain, just compensation is measured by:

   A. The price the owner originally paid

   B. The property’s assessed value for taxes

   C. The property’s fair market value at the time of the taking

   D. The cost to rebuild the improvements new

3. **5 pts**

   Property escheats to the state when its owner dies:

   A. Without a will and without any heirs

   B. Without a will, leaving only distant cousins

   C. With a will leaving everything to a charity

   D. Owing more in property taxes than the land is worth

4. 5 pts

In this example, a ranch is worth $600,000 before the state takes a strip for a highway. The strip itself is worth $80,000, and the remaining land is worth $470,000 after the taking. What are the severance damages?

A. $130,000

B. $80,000

C. $50,000

D. $470,000

5. 5 pts

An owner's lot is so narrow and steep that no house can meet the required side setbacks. The owner should apply for a:

A. Rezoning

B. Variance

C. Conditional use permit

D. Nonconforming use

6. 5 pts

A small grocery has operated on a corner since 1955. In 1980 the neighborhood was zoned single-family residential. The grocery may continue as a(n):

A. Variance

B. Spot zoning

C. Conditional use

D. Nonconforming use

7. 5 pts

Spot zoning is BEST described as:

A. Rezoning a single parcel inconsistently with the comprehensive plan, for the benefit of its owner

B. Granting a variance for a hardship unique to one lot

C. Approving a church in a residential district

D. Mapping a flood hazard area on one parcel

8. 5 pts

The zoning for a subdivision permits duplexes. The subdivision's recorded CC&Rs allow only single-family homes. An owner wants to build a duplex. Which is correct?

A. The duplex is allowed because zoning is public law and overrides private agreements

B. Only a single-family home may be built because the more restrictive rule governs

C. The owner may choose whichever rule he prefers

D. The city must enforce the CC&Rs before the owner can build

9. 5 pts

A neighbor violates a restrictive covenant in the subdivision declaration by building a fence twice the allowed height. The usual remedy for the other owners is:

A. Forfeiture of the neighbor's title

B. Condemnation of the fence

C. Escheat of the lot to the association

D. An injunction ordering the fence removed or lowered

10. 5 pts

For ten years the owners in a subdivision ignored a neighbor's workshop that violated the CC&Rs while he expanded it at great expense. When they finally sue, he argues they waited too long. His defense is:

A. Merger

B. Escheat

C. Laches

D. Abandonment of the easement

11. 5 pts

An owner stops paying the dues and special assessments of his homeowners' association. Under the typical declaration and state law, the unpaid amounts:

A. Become a lien on his lot

B. Are forgiven after one year

C. Must be paid by the other owners

D. Are collected by the county assessor

12. 5 pts

In this example, a home has a market value of $300,000. The state assesses property at 80% of market value, the owner has no exemptions, and the tax rate is 25 mills. What is the annual tax?

A. $7,500

B. $6,000

C. $600

D. $60,000

13. 5 pts

In this example, a school district must raise $3,000,000 in property taxes from a district whose total taxable value is $200,000,000. What tax rate must it levy?

A. 1.5 mills

B. 0.15 mills

C. 15 mills

D. 150 mills

14. 5 pts

Which statement about a special assessment is correct?

A. It is an ad valorem tax paid by every property owner in the county

B. It is a voluntary lien the owner signs to pay for improvements

C. It is charged only when a property is sold

D. It is charged to the properties that benefit from a specific public improvement

15. 5 pts

A mortgage on a house was recorded in 2018. In 2025 the owner fails to pay real property taxes. Which lien has priority?

A. The real property tax lien

B. The mortgage, because it was recorded first

C. Whichever lienholder forecloses first

D. Neither; they share equally

16. 5 pts

Under the federal lead-based paint disclosure rule for the sale of a house built in 1965, all of the following are required EXCEPT:

A. Giving the buyer the EPA lead hazard pamphlet

B. Including the Lead Warning Statement in the contract

C. Offering the buyer a 10-day opportunity to test for lead

D. Removing all lead-based paint before closing

17. 5 pts

Radon is BEST described as:

A. A fibrous mineral used in older insulation

B. A chemical once added to house paint

C. A colorless, odorless radioactive gas from the natural decay of uranium in soil

D. A mold that grows behind damp walls

18. 5 pts

Under CERCLA, liability for cleaning up a contaminated site is:

A. Strict, joint and several, and retroactive

B. Limited to the party that actually dumped the waste

C. Avoided by any owner who buys the land “as is”

D. Limited to the purchase price the current owner paid

19. 5 pts

A buyer of a former industrial site wants to qualify for the innocent landowner defense. She should, before closing:

A. Ask the seller to sign an “as is” clause

B. Obtain a Phase I environmental site assessment showing all appropriate inquiry

C. Record a deed restriction against future dumping

D. Purchase a standard homeowners policy

20. 5 pts

A buyer is financing a home with a VA-guaranteed loan. FEMA maps the home in Zone VE on the coast. Which is true?

A. Flood insurance is optional because the homeowners policy covers flood

B. Flood insurance is required only if the home flooded in the last ten years

C. Flood insurance is never required on VA loans

D. Flood insurance is required because the home is in a special flood hazard area and the loan is federally backed

ANSWER KEY

1. B. Zoning regulates the use of land for health, safety and general welfare — the police power — and ordinarily requires no compensation. A is the classic trap: eminent domain takes title and must pay.
2. C. Just compensation is fair market value at the time of the taking. Assessed value may differ from market value, and the owner's original price is irrelevant.
3. A. Escheat requires both no will and no heirs who can inherit. Distant relatives usually inherit under intestacy statutes, and a will to a charity controls; unpaid taxes lead to a tax sale, not escheat.
4. C. Total just compensation is value before minus value after: $600,000 − $470,000 = $130,000. Of that, $80,000 pays for the strip, so severance damages — the loss in value of the remainder — are $50,000. A is the total award, not the severance damages.
5. B. A variance grants relief from a dimensional requirement when the property's unique conditions cause unnecessary hardship. A conditional use permit concerns a use, and a rezoning changes the district.
6. D. A use that was lawful before the zoning changed may continue as a legal nonconforming ("grandfathered") use, though it generally may not expand, and abandonment can end it.
7. A. Spot zoning singles out one parcel for treatment inconsistent with the plan and the surrounding area, and courts generally hold it illegal. B describes a lawful variance.
8. B. When public and private restrictions conflict, the more restrictive generally governs. Zoning does not override a stricter recorded covenant, and the CC&Rs are enforced by the association and owners, not the city.
9. D. A covenant is enforced by injunction or damages. Forfeiture of title is the remedy for breach of a condition, not a covenant.
10. C. Laches bars enforcement when a party unreasonably delays and the delay harms the other side. Merger ends a covenant when one owner acquires both benefited and burdened land.
11. A. Unpaid association assessments become a lien on the owner's lot, which in many states the association may foreclose. That is why buyers check association status before closing.
12. B. Assessed value is $300,000 × 0.80 = $240,000. Twenty-five mills is 0.025, so the tax is $240,000 × 0.025 = $6,000. A applies the rate to market value instead of

assessed value.

13. C. The rate is the amount needed divided by total taxable value: $3,000,000 ÷ $200,000,000 = 0.015, which is 15 mills ($15 per $1,000, or $1.50 per $100).
14. D. A special assessment pays for a particular improvement, such as a sidewalk or sewer, and is charged only to benefited properties, often by front footage. It is an involuntary lien, not a general ad valorem tax.
15. A. Real property tax and special-assessment liens take priority over other liens, even an earlier-recorded mortgage. That is why lenders collect taxes through escrow accounts.
16. D. The rule requires disclosure, not removal: disclosure of known paint and reports, the pamphlet, the warning statement, a 10-day testing opportunity and 3 years of record keeping. Watch the word EXCEPT.
17. C. Radon is a natural radioactive gas that enters buildings through foundations; it can be detected only by testing, and the EPA recommends fixing homes at 4 pCi/L or more. A describes asbestos and B lead.
18. A. CERCLA liability requires no proof of fault, can fall entirely on any one responsible party and reaches disposal before 1980. A current owner can be liable for others' dumping, and an "as is" clause does not bind the government.
19. B. The innocent landowner defense, added by SARA in 1986, requires all appropriate inquiry before purchase — in practice a Phase I assessment — and no knowledge or reason to know of the contamination.
20. D. Zones beginning with A or V are special flood hazard areas, and a federally backed loan on a building there requires flood insurance. Standard homeowners policies exclude flood.

PORTFOLIO PIECE: MY PATHWAY FILE — LAND USE, TAXES AND THE ENVIRONMENT

Assemble the land-use section of your Pathway File: the PETE map of your own county with its worked partial-taking calculation (3.1); the zoning fact sheet for a real parcel, with the scaled drawing of setbacks, buildable footprint and coverage (3.2); the buyer's summary of a real association packet, with the sharing rule and a computed special assessment (3.3); the rebuilt tax statement showing every district's levy, the rate in mills and per $100, and the pretend property's tax and assessment (3.4); and the environmental due-diligence checklist with the flood-zone lookup and the nearest Superfund site (3.5).

Close the section with a one-page memo to a pretend first-time buyer titled "Five Things No One Sees at a Showing": name one limit from each lesson — a government power, a zoning rule, a private covenant, a tax or assessment, and an environmental hazard — and explain in plain words how a buyer finds out about each before signing. Date every page.

LOOK FOR	WHAT IT MEANS
Four powers map	Each power is defined in exam language with a real local example, and the partial-taking calculation separates the part taken from severance damages correctly.
Zoning fact sheet	The district, permitted and conditional uses, and bulk rules are recorded accurately, and the scaled drawing's buildable footprint, coverage and FAR are computed correctly.
Association buyer's summary	The summary names the documents, the restrictions most likely to surprise a buyer with section numbers, the amendment rule, the lien for unpaid dues and a correctly computed assessment share.
Tax statement rebuild	Every levy is listed and summed, the rate is shown in mills, per $100 and as a decimal, and the recomputed tax matches the statement or the difference is explained.
Environmental checklist	All hazards are sorted into building, ground and land with a warning sign and a confirming test or professional for each, and the lead rule, flood zone and Superfund lookup are complete and dated.
Buyer memo	Written in the student's own words, the memo names one limit from each lesson, explains how a buyer discovers it, and keeps

LOOK FOR	WHAT IT MEANS
	the licensee's role to disclosing and referring.

UNIT 4

Valuation

In 1989 Congress rewrote the rules for every appraiser in America because a generation of bad estimates of value had helped bring down more than a thousand savings institutions. Value is that important. This unit teaches you to think about worth the way appraisers, lenders and the national exam do. You will separate **value** from **price** and **cost**, define **market value** precisely, and learn the principles — **substitution**, **highest and best use**, **conformity**, **contribution**, **progression** and **regression** — that explain why one house is worth more than another. You will meet the appraiser, the **USPAP** standards and the federal law that licenses appraisers, and learn why a licensee's **CMA** or **BPO** is not an appraisal.

Then you will do the work itself, three ways. In the **sales comparison approach** you will adjust comparable sales toward the subject — comp better, subtract; comp worse, add — and reconcile a three-comp grid. In the **cost approach** you will price a building new, subtract physical, functional and external **depreciation**, and add the land. In the **income approach** you will build net operating income from gross rents and capitalize it with a **cap rate**, and you will value small rentals with a **gross rent multiplier**. This is a math-heavy unit: keep a calculator beside your notebook, show every step, and check each answer by asking whether it makes sense for a real house on a real street.

PREREQUISITES

- Can compute percents, percent change and simple ratios, and solve a one-step equation for an unknown (I = R × V for V)
- Can compute area in square feet and multiply area by a cost per square foot
- Can explain the four powers of government and why zoning limits what can be built on a lot (Unit 3)
- Has the exam notebook current, with Unit 3's property-tax chain and the difference between assessed value and market value

MASTERY CHECKLIST

- ☐ I can distinguish value, price and cost, state the elements of market value, and name the four characteristics of value (DUST) and the four forces.
- ☐ I can define and apply the principles of value and test highest and best use in the correct order.
- ☐ I can explain FIRREA, USPAP and The Appraisal Foundation, list the steps of the appraisal process, and tell an appraisal from a CMA, BPO or AVM.
- ☐ I can select arm's-length comparables and adjust them toward the subject using comp better, subtract; comp worse, add — including time and concessions.
- ☐ I can complete and reconcile a three-comp adjustment grid, weighting the comp with the fewest and smallest adjustments.
- ☐ I can value a property by the cost approach, classify depreciation as physical, functional or external and curable or incurable, and compute age-life depreciation.
- ☐ I can build NOI from potential gross income, exclude debt service and depreciation, and solve any form of the IRV formula.
- ☐ I can compute and apply a GRM and a GIM and reconcile the three approaches by the property type.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **The Appraisal Foundation: USPAP**: Free, official. The home of the Uniform Standards of Professional Appraisal Practice, with a free online version of the current edition. Skim its Ethics and Competency rules during Lesson 4.2. Ages 15 and up.
- **Appraisal Subcommittee (ASC)**: Free, official. The federal agency created by FIRREA to oversee state appraiser licensing; its national registry lets anyone confirm an appraiser's credential. Used in the Lesson 4.2 project. Ages 15 and up.
- **CFPB: What are appraisals and why do I need to look at them?**: Free, official. The Consumer Financial Protection Bureau's plain explanation of home appraisals for borrowers. Read it with Lesson 4.2. Ages 14 and up.
- **CFPB: Do I have the right to receive a copy of my home appraisal?**: Free, official. Explains the federal rule that gives mortgage applicants free copies of appraisals and valuations before closing. Use it for the Lesson 4.2 extension. Ages 14 and up.
- **FHFA House Price Index**: Free, official. The Federal Housing Finance Agency's index of home-price changes by state and metro area. Use it in Lesson 4.3 to see how appraisers support a market-conditions (time) adjustment. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

4.1	**What Makes Value**	3 sessions of 50 minutes
4.2	**The Appraiser and the Appraisal**	3 sessions of 50 minutes
4.3	**The Sales Comparison Approach**	3 sessions of 50 minutes
4.4	**The Cost Approach and Depreciation**	3 sessions of 50 minutes
4.5	**The Income Approach**	3 sessions of 50 minutes

Unit 4 Test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a

timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Seventy percent (14 of 20) matches the common passing line, but aim higher. Figures marked “in this example” are examples — real adjustment values, construction costs and cap rates vary by market and year. Choose the one BEST answer, and show your arithmetic on scratch paper.

1. **5 pts**

   The four characteristics a property must have to have value are:

   A. Demand, utility, scarcity and transferability

   B. Location, size, age and condition

   C. Supply, demand, cost and price

   D. Physical, economic, governmental and social

2. **5 pts**

   The largest and most expensive house on a street of modest homes is likely to be worth less than an identical house in a neighborhood of similar homes. This illustrates:

   A. Progression

   B. Substitution

   C. Regression

   D. Plottage

3. **5 pts**

   In analyzing highest and best use, which test is applied FIRST?

   A. Maximally productive

   B. Legally permissible

   C. Financially feasible

   D. Physically possible

4. **5 pts**

   In this example, an owner spends $40,000 on an in-ground pool, and appraisers find it adds $15,000 to market value. Which principle explains the difference?

   A. Anticipation

   B. Competition

   C. Conformity

   D. Contribution

5. 5 pts

A developer buys three adjoining lots and combines them into one site worth more than the three lots separately. The increase in value is called:

A. Assemblage

B. Plottage

C. Progression

D. Accretion

6. 5 pts

Following the savings-and-loan crisis, which law requires state-licensed or state-certified appraisers for federally related transactions?

A. FIRREA (1989)

B. RESPA (1974)

C. TILA (1968)

D. The Fair Housing Act (1968)

7. 5 pts

The Uniform Standards of Professional Appraisal Practice (USPAP) are issued by:

A. The Consumer Financial Protection Bureau

B. Each state's real estate commission

C. The Federal Reserve

D. The Appraisal Foundation's Appraisal Standards Board

8. 5 pts

A listing agent compares recent sales, pending sales and active listings to help a seller choose a list price. This document is:

A. An appraisal, if the agent is licensed

B. A broker price opinion required by FIRREA

C. A comparative market analysis, which is not an appraisal

D. An automated valuation model

9. 5 pts

What is the FIRST step of the appraisal process?

A. Define the problem

B. Collect comparable sales

C. Apply the three approaches

D. Reconcile the value indications

10. 5 pts

In the sales comparison approach, a comparable has a swimming pool and the subject does not. The appraiser should:

A. Add the value of the pool to the subject's value

B. Subtract the value of the pool from the comparable's sale price

C. Add the value of the pool to the comparable's sale price

D. Ignore the pool because the subject lacks one

11. 5 pts

In this example, a comparable sold for $400,000. It has an extra bathroom the subject lacks, worth $8,000, but no garage, while the subject has a garage worth $10,000. What is the comparable's adjusted price?

A. $382,000

B. $398,000

C. $402,000

D. $418,000

12. 5 pts

Which sale would be the LEAST reliable comparable for a single-family appraisal?

A. A similar home in the same subdivision that closed last month

B. A similar home three blocks away that closed four months ago

C. A home of the same model and age that closed two months ago

D. A similar home sold by a mother to her son at a reduced price

13. 5 pts

In this example, a house would cost $450,000 to replace new. It has an effective age of 15 years and an economic life of 50 years, and the land is worth $100,000. What is the value by the cost approach?

A. $415,000

B. $550,000

C. $385,000

D. $315,000

14. 5 pts

A new airport runway brings constant jet noise over a quiet subdivision. The loss in value to the homes is:

A. Physical deterioration, curable

B. Functional obsolescence, incurable

C. Functional obsolescence, curable

D. External obsolescence, incurable

15. 5 pts

The cost to build a structure of equal utility using modern materials and design at today's prices is called:

A. Reproduction cost

B. Replacement cost

C. Historical cost

D. Accrued depreciation

16. 5 pts

The cost approach is generally MOST reliable for appraising:

A. A 70-year-old single-family home in an active market

B. A small apartment building with stable rents

C. A newly built church

D. A vacant residential lot

17. 5 pts

Which item is NOT deducted from effective gross income in computing net operating income?

A. Property taxes

B. Management fees

C. Reserves for replacement

D. Mortgage principal and interest

18. 5 pts

In this example, an apartment building has a net operating income of $90,000, and comparable sales indicate a capitalization rate of 7.5%. What is its value?

A. $675,000

B. $1,200,000

C. $1,125,000

D. $12,000,000

19. 5 pts

In this example, a rental house sold for $270,000 when it rented for $1,800 a month. A similar house rents for $1,900 a month. Using a gross rent multiplier, its indicated value is about:

A. $3,420,000

B. $270,000

C. $285,000

D. $300,000

20. 5 pts

After applying all three approaches, an appraiser arrives at a final opinion of value by:

A. Giving the most weight to the approach most applicable to the property type

B. Averaging the three indications equally

C. Choosing the highest indication to protect the seller

D. Choosing the lowest indication to protect the lender

ANSWER KEY

1. A. DUST — demand backed by purchasing power, utility, scarcity and transferability. D lists the four forces that influence value, a common swap.
2. C. Regression: a better property loses value among lesser ones. Progression is the reverse — the modest house that gains from better neighbors.
3. B. The tests run in order: legally permissible, physically possible, financially feasible, maximally productive. A use the law forbids is eliminated before anything else is considered.
4. D. Contribution: a component is worth what it adds to value, not what it cost. Conformity concerns similarity to neighboring properties.
5. B. Plottage is the increment in value from combining parcels; assemblage is the act of combining them — the classic pair the exam likes to swap.
6. A. Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 created the licensed and certified appraiser requirement. RESPA and TILA govern settlement and credit disclosures.
7. D. USPAP is issued by the Appraisal Standards Board of The Appraisal Foundation, which Congress authorized through FIRREA. States license appraisers but do not write USPAP.
8. C. A CMA is a licensee's marketing analysis. It is not an appraisal and may not be called one; a BPO is usually prepared for a lender, and an AVM is computer-generated.
9. A. The appraiser first defines the problem — client, intended use, type of value, effective date and property rights — then sets the scope, collects data, analyzes highest and best use, applies the approaches, reconciles and reports.
10. B. Adjust the comparable, never the subject. The comp is better, so subtract (comp better, subtract).
11. C. Bathroom: comp better, subtract $8,000. Garage: comp worse, add $10,000. $400,000 − $8,000 + $10,000 = $402,000. B reverses both directions.
12. D. A sale between relatives is not an arm's-length transaction, so its price does not reflect market value. Good comps are recent, nearby, similar and arm's length.
13. A. Depreciation is 15/50 = 30% of $450,000 = $135,000; the building is worth $315,000; adding land gives $415,000. C wrongly depreciates the land, B ignores depreciation, and D forgets the land.

14. D. A cause outside the property is external (economic) obsolescence, and because the owner cannot fix it, it is always incurable.
15. B. Replacement cost means equal utility with modern materials; reproduction cost is an exact replica with the original materials and design.
16. C. The cost approach serves new buildings and special-purpose properties that rarely sell and produce no rent, such as churches and schools. Vacant land is valued by sales comparison, and apartments by income.
17. D. Debt service depends on the buyer's financing, not the property, so it is never an operating expense. Taxes, management and reserves are.
18. B. Value = income ÷ rate: $90,000 ÷ 0.075 = $1,200,000. A multiplies instead of dividing; D misplaces the decimal.
19. C. GRM = $270,000 ÷ $1,800 = 150; value = 150 × $1,900 = $285,000. A applies the multiplier to annual rent — the GRM uses monthly rent.
20. A. Reconciliation is a reasoned weighting, favoring the approach best suited to the property — sales comparison for homes, income for rentals, cost for special-purpose buildings — never a simple average or a choice to favor a party.

PORTFOLIO PIECE: MY PATHWAY FILE — VALUATION

Assemble the valuation section of your Pathway File: the Principles Field Guide from a real neighborhood with its highest-and-best-use analysis (4.1); the "Appraisal or Not?" comparison sheet with the eight-step process and a practice CMA (4.2); the three-comp sales comparison grid in a spreadsheet, tested against the lesson and then applied to real local sales (4.3); the cost-approach worksheet tested against both worked examples and applied to a real older house (4.4); and the income property analysis with its stack, sensitivity table and GRM check (4.5).

Close the section with a one-page reconciliation memo for a single pretend property of your choosing: report the value indicated by each approach you could apply, explain which deserves the most weight and why, and state a final opinion of value with its effective date — clearly labeled as a student exercise and not an appraisal. Date every page.

LOOK FOR	WHAT IT MEANS
Principles field guide	Each principle is matched to a real, specific example, the neighborhood's life-cycle stage is supported with evidence, and the highest-and-best-use analysis applies the four tests in order.
Appraisal-or-not sheet	The four valuation types are correctly distinguished by preparer, purpose and legal use, the process steps are in order, and the practice CMA's price-per-square-foot arithmetic is correct.
Sales comparison grid	The spreadsheet reproduces the lesson's adjusted prices and reconciled value exactly, every adjustment on the real-sales grid goes in the correct direction, and the weighting is justified by gross adjustments.
Cost approach worksheet	The sheet returns $446,040 and $550,000 on the lesson's examples, the real house's depreciation is classified by type and curability, and land is never depreciated.
Income analysis	NOI is built in the correct order with debt service and depreciation excluded, the sheet returns $139,200 and $1,740,000 on the lesson's example, and the sensitivity table shows the inverse cap-rate relationship.

LOOK FOR	WHAT IT MEANS
Reconciliation memo	Written in the student's own words, it weights the approaches by property type rather than averaging, states an effective date, and is honestly labeled as a student exercise rather than an appraisal.

4.1 What Makes Value

OBJECTIVES

- Distinguish value, price and cost, and state the elements of the definition of market value.
- Name the four characteristics of value (DUST) and the four forces that influence value.
- Define and apply the principles of value: supply and demand, substitution, highest and best use, conformity, contribution, increasing and decreasing returns, progression and regression, anticipation, change, competition, and plottage and assemblage.
- Apply the four tests of highest and best use in their proper order.
- Describe the life cycle of a neighborhood and compute plottage value and the contribution of an improvement.

> **Warm-up.** A glass of water and a diamond ring sit on a table. In five minutes, write which is more useful, which costs more, and why those two answers are different. Then write one sentence about a house: can a house be useful and still be worth less than it cost to build? Keep the paper; Adam Smith asked the same question in 1776.

WATCH

Real Estate Appraisal: Principles of Value

Azure Tide All Florida School of Real Estate · 10:17

https://www.youtube.com/watch?v=Crt_5q0-O-g

> **WHEN TO WATCH**
> Watch after the third core idea; the narrator speaks slowly for note-taking, so pause on each principle and write its name, a one-line definition and a house example of your own.

BACKUP VIDEO

Principle of Highest and Best Use | Real Estate Exam Prep | Appraisals

PrepAgent · 5:28

https://www.youtube.com/watch?v=C6Qd-RsoXD8

A focused second pass on highest and best use — watch before the practice set and write the four tests in order as he explains each one.

value

The present worth of future benefits arising from the ownership of property; what a property is worth, as opposed to what it sells for or cost to build.

price

The amount actually paid for a property in a particular transaction.

cost

The total spent to produce or build an improvement — labor, materials and overhead.

market value

The most probable price a property should bring in a competitive, open market under all conditions requisite to a fair sale, with buyer and seller each acting prudently and knowledgeably and the price not affected by undue stimulus.

DUST

The four characteristics of value: demand (backed by purchasing power), utility, scarcity and transferability.

substitution

The principle that a buyer will pay no more for a property than the cost of acquiring an equally desirable substitute; the basis of all three appraisal approaches.

highest and best use

The reasonably probable use of land or improved property that is legally permissible, physically possible, financially feasible and maximally productive.

conformity

The principle that value is maximized when a property is reasonably similar to the others around it.

contribution

The principle that a component is worth what it adds to the property's value, regardless of its cost.

progression and regression

The rise in value of a lesser property among better ones (progression) and the loss in value of a better property among lesser ones (regression).

anticipation

The principle that value is created by the expectation of future benefits; the foundation of the income approach.

plottage

The increase in value when two or more parcels are combined (assembled) into one more useful parcel; assemblage is the act of combining them.

CORE IDEAS

The story. In 1776 a Scottish professor named Adam Smith published *The Wealth of Nations*, and in its fourth chapter he set down a puzzle that has followed every appraiser since. "Nothing is more useful than water," he wrote, "but it will purchase scarce any thing." A diamond, on the other hand, "has scarce any value in use," yet a great quantity of other goods may be had in exchange for it. Smith called the first kind of worth **value in use** and the second **value in exchange**, and he noticed that they could point in opposite directions. Real estate lives inside Smith's puzzle. A sturdy farmhouse on a back road may be enormously useful to the family inside it and still bring a modest price; a small cottage near a busy harbor may bring a fortune. The appraiser's whole craft begins with a question Smith made famous: worth to whom, measured how?

How they figured it out. A century later, the English economist Alfred Marshall, in his *Principles of Economics* (1890), resolved the puzzle by showing that price is set where supply and demand meet — like the two blades of a pair of scissors, neither cutting alone. Water is useful but abundant; diamonds are less useful but scarce and wanted. Value depends on *both* usefulness and scarcity, and on buyers able to pay. American appraisers turned these ideas into working rules in the early twentieth century, as lenders and courts demanded consistent valuations; in 1932 the American Institute of Real Estate Appraisers was formed, and the profession's textbooks collected a list of "principles of value" that every licensing exam still tests. Those principles explain why a house is worth what it is, and they are the reasons behind every adjustment you will make in Lessons 4.3 through 4.5.

The big idea. Keep three words apart. **Value** is what a property is worth — the present worth of its future benefits. **Price** is what someone actually paid. **Cost** is what it took to build. They can differ widely: a custom house may cost more to build than it will sell for, and a hurried sale may bring a price below value. The appraiser's usual target is **market value**: the most probable price a property should bring in a

competitive, open market, with buyer and seller typically motivated, each well informed and acting in what each considers his own best interest, a reasonable time allowed for exposure on the market, an **arm's-length** transaction (unrelated parties, no pressure), and payment in cash or its financial equivalent. For property to have value at all it needs four characteristics — **DUST: demand** backed by purchasing power, **utility**, **scarcity** and **transferability**. Four forces move value: **physical** (terrain, climate, soil), **economic** (jobs, interest rates), **governmental** (zoning, taxes, services) and **social** (population, household size, preferences).

The principles of value come next, and the exam asks for each by definition. **Supply and demand:** more buyers than houses raises prices. **Substitution:** a buyer will pay no more than the cost of an equally desirable substitute — the root of all three appraisal approaches. **Highest and best use** is the reasonably probable use that is, tested in this order, **legally permissible**, **physically possible**, **financially feasible** and **maximally productive.** It is analyzed for the land as if vacant and for the property as improved; an old house on land now worth more for offices may be an **interim use.** **Conformity**: value is greatest when a home is reasonably similar to its neighbors. **Progression:** a modest house gains from better neighbors. **Regression:** the finest house on a modest street loses. **Contribution:** a component is worth what it adds, not what it cost. In this example, a $45,000 swimming pool that raises a home's value by $18,000 contributes $18,000.

Increasing and decreasing returns describe what happens as owners keep improving. At first, each dollar spent adds more than a dollar of value (increasing returns); past some point, each added dollar adds less (decreasing returns, the law of diminishing returns). **Anticipation** says value is created by the expected future benefits of owning — which is why the income approach capitalizes future income and why a planned light-rail station raises nearby prices before it opens. **Change** says that the forces affecting value never stop moving. **Competition** says that unusual profits attract competitors until the profits shrink — a hugely profitable store invites a rival across the street. **Plottage** is the added value created by combining parcels into one more useful site; **assemblage** is the act of combining them. In this example, two adjoining lots worth $150,000 each, once assembled, are worth $380,000 as one development site; the plottage value is $380,000 − $300,000 = $80,000.

Neighborhoods have lives, and appraisers describe four stages. In **growth** (development), land is being built on and values rise as demand meets new supply. In **stability** (equilibrium), the area is built out and values hold steady. In **decline**, buildings age, maintenance slips and values fall relative to newer areas. In **revitalization** (renewal), new buyers and investors restore the area and values rise again. Not every neighborhood passes through every stage, and none does so on a schedule; the cycle is a way of asking which direction the forces of value are pushing. Notice how the principles tie together here: anticipation drives buyers into a growing neighborhood, conformity protects values in a stable one, regression drags down the overbuilt house in a declining one, and change is the law over all of them. A licensee who understands these principles can explain to a seller why the remodeled kitchen did not add its full cost, or to a buyer why the largest house on the block may be the weakest investment.

On the exam today. Valuation is about 8% of the PSI national outline and 11 of Pearson VUE's 80 scored items, and these definitions are its foundation. Expect "which principle?" questions: the best house in a modest neighborhood (**regression**); the modest house among fine ones (**progression**); a buyer won't pay more than a comparable house costs (**substitution**); a pool that cost more than it added (**contribution**); combining lots raises value (**plottage**); value from expected future benefits (**anticipation**). Know DUST and the order of the highest-and-best-use tests — legally permissible first. The traps: confusing value, price and cost; thinking contribution means the cost of an improvement; thinking highest and best use means the current use (it may not be) or the most expensive use (it must be legal, possible and feasible); mixing up progression and regression; and confusing plottage (the increment in value) with assemblage (the act of combining).

PICTURE STUDY



Houses on the Herengracht, Amsterdam, Jan van der Heyden (figures by Adriaen van de Velde), c. 1670 · Oil on panel · Private collection

Image: Wikimedia Commons, public domain

Jan van der Heyden was a Dutch painter who was also an inventor: he designed Amsterdam's street lighting and an improved fire engine, and he painted his city with an engineer's precision. His friend Adriaen van de Velde often painted the small figures. The Herengracht — the "Gentlemen's Canal" — was Amsterdam's most prestigious address in the 1600s, lined with merchants' houses of similar size and dignity. It opens this lesson because nearly every principle of value is visible here: location people pay for, houses that conform to one another, and a street whose worth has been tracked for centuries.

Look closely

- Compare the gables. Each house is individual, yet all are similar in height, width and materials — conformity, which protects value for the whole row.
- Look at the trees and the water in front. Canals and shade were amenities buyers paid for — location and utility at once.
- Find the people working along the quay. Demand for these houses came from the trade that flowed past their doors.
- Notice how deep and narrow the lots are. Canal frontage was scarce, so lots were laid out to give as many owners as possible a piece of it.

Talk about it

1. Which principle of value explains why a plain house on the Herengracht might be worth more than a grand one on a back street?
2. If one owner had built a house twice as tall as all the others, which principle would warn him about its value?
3. The merchant in Matthew 13 sold everything for one pearl of great price. What did he understand about value that a careless buyer would miss — and what does that suggest about the things worth more than any house?

PROJECT

The Principles Field Guide

You will walk (or drive with a parent) through one neighborhood near you and photograph or sketch real examples of the principles of value, building a field guide you will use again in the sales comparison project. Photograph only from public streets and never include people or house numbers.

You will need

- A phone camera or a sketchbook
- A printed list of the principles of value from this lesson
- Your exam notebook and a pencil
- A parent or mentor as a companion

Steps

1. Choose one neighborhood and write its name, approximate age and which stage of the life cycle you think it is in, with one reason.
2. Find and record one example each of conformity and of a nonconforming house (much larger, smaller or different in style than its neighbors).
3. Find an example of an improvement that may not contribute its full cost (an elaborate addition, a pool in a cold climate) and write one sentence applying the principle of contribution.
4. Find evidence of change or anticipation — a construction site, a new road, a vacant lot for sale, a business opening or closing.
5. Identify one vacant or underused lot and write a short highest-and-best-use analysis using the four tests in order.
6. Write the DUST characteristics as they apply to one house you saw.
7. Assemble the page as “Principles Field Guide,” date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every principle — front: the principle; back: the definition and a one-line house example.

2. Draw a staircase of four steps labeled LEGALLY PERMISSIBLE → PHYSICALLY POSSIBLE → FINANCIALLY FEASIBLE → MAXIMALLY PRODUCTIVE, and write an eliminated use on each step.
3. Write a five-line trap list titled "Value," ending with: CONTRIBUTION is what a feature ADDS, never what it COST.

KEY FORMULAS

$$\text{Contribution of a component} = \text{value with it} - \text{value without it}$$
$$\text{Plottage value} = \text{value of assembled parcel} - \text{sum of separate parcel values}$$
$$\text{Value} \neq \text{price} \neq \text{cost}$$

From history. Economist Piet Eichholtz built a price index for the houses on Amsterdam's Herengracht — the very canal in today's picture — from sales records reaching back to 1628. Tracked for three and a half centuries, prices swung through long booms and busts, yet after adjusting for inflation they ended roughly where they began. The study is a reminder that value is driven by real demand, scarcity and utility, not by a rule that prices always rise.

WORKED EXAMPLES

Example 1. In this example, a vacant 2-acre lot is zoned for single-family homes and offices. A study shows: a gas station would earn the most but is not permitted by zoning; a 10-story office tower is permitted but the soil cannot support it; a 3-story office building is permitted, buildable and would produce a land value of $1.2 million; four single-family homes are permitted, buildable and would produce a land value of $900,000. What is the highest and best use?

Show solution

1. Test 1, legally permissible: the gas station fails; zoning does not allow it.
2. Test 2, physically possible: the 10-story tower fails; the soil will not support it.
3. Test 3, financially feasible: both the 3-story office building and the homes produce a positive land value.
4. Test 4, maximally productive: the office building produces the higher land value, $1.2 million versus $900,000.

Answer: The 3-story office building. Apply the four tests in order — legal, physical, financial, maximally productive — and eliminate uses at each step.

Example 2. In this example, a developer buys three adjoining lots for $120,000, $125,000 and $135,000. Combined, the site is large enough for a small apartment building, and an appraiser values the assembled site at $470,000. Find the plottage value and name the principle.

Show solution

1. Sum the separate values: $\$120{,}000 + \$125{,}000 + \$135{,}000 = \$380{,}000$.
2. Subtract from the assembled value: $\$470{,}000 - \$380{,}000 = \$90{,}000$.
3. Combining the lots is assemblage; the increase in value is plottage.

Answer: Plottage value is $90,000 — the extra worth created because the combined site permits a more productive use than any lot alone.

Example 3. Exam style. In this example, an owner spends $60,000 adding a luxury home theater and a fourth garage bay to the largest house on a street of modest homes. An appraiser finds the additions raise the market value by only $20,000. Which principles BEST explain the result?

A. Progression and anticipation
B. Contribution and regression
C. Substitution and plottage
D. Competition and change

Show solution

1. Contribution: a component is worth what it adds to value ($20,000), not what it cost ($60,000).
2. Regression: the best house on a street of lesser homes is held back in value by its neighbors, so improvements above the neighborhood standard recover little.
3. Progression would describe the modest homes benefiting from this one — the opposite direction.

Answer: B. Contribution explains why cost ≠ added value; regression explains why an overimproved house in a modest neighborhood cannot capture its cost.

PRACTICE

1. Easy What do the letters DUST stand for?

Show answer

Demand (backed by purchasing power), utility, scarcity and transferability — the four characteristics a property must have to have value.

2. Easy Define value, price and cost in one line each.

Show answer

Value is what the property is worth (the present worth of future benefits); price is what was actually paid; cost is what it took to build the improvement.

3. Easy What principle says a buyer will not pay more for a house than the cost of an equally desirable one nearby?

Show answer

Substitution — the basis of the sales comparison, cost and income approaches alike.

4. Medium List the four tests of highest and best use in the order they are applied.

Show answer

Legally permissible, physically possible, financially feasible and maximally productive.

5. Medium A modest two-bedroom cottage sits on a street of large, expensive homes and sells for more than similar cottages elsewhere. Which principle applies?

Show answer

Progression — a lesser property gains value from being among better ones.

6. Medium In this example, a homeowner spends $30,000 on a new kitchen, and appraisers find the home's value rose from $410,000 to $432,000. What did the kitchen contribute, and what principle does this show?

Show answer

It contributed $\$432{,}000 - \$410{,}000 = \$22{,}000$, less than its $30,000 cost. The principle of contribution: a component is worth what it adds, not what it cost.

7. Medium A buyer pays well above market value for the house next door to her parents. Is the sale price a good indication of market value? Why?

Show answer

No. Market value assumes typically motivated buyers and sellers in an arm's-length transaction; her special motivation makes the price unrepresentative.

8. Hard In this example, two adjoining lots are worth $\$85{,}000$ and $\$95{,}000$ separately; assembled, they are worth $\$230{,}000$. Find the plottage value.

Show answer

$\$230{,}000 - (\$85{,}000 + \$95{,}000) = \$50{,}000$. Assemblage is the act of combining; plottage is the $\$50{,}000$ increment.

9. Hard Explain the law of increasing and decreasing returns with a remodeling example.

Show answer

Early improvements, such as fixing a leaking roof or painting, add more value than they cost (increasing returns). Beyond a point, added spending — a third remodeled bathroom, marble floors — adds less value than it costs (decreasing returns).

10. Hard An old single-family house sits on land now zoned and in demand for a small office building, and the land as if vacant is worth more than the house and land together. What is the house's use called, and what does that suggest?

Show answer

An interim use. The highest and best use of the land as if vacant is the office building, so the house will likely be removed when redevelopment becomes feasible.

11. Challenge A town announces a new university campus nearby. Before construction begins, home prices in the area rise. Name two principles at work and explain.

Show answer

Anticipation — buyers pay now for expected future benefits — and supply and demand, as more buyers compete for the same houses. Change also applies: the forces affecting value have shifted.

12. **Challenge** Use the four stages of a neighborhood's life cycle to advise a buyer comparing a brand-new subdivision with a 70-year-old neighborhood in revitalization. Write three sentences.

Show answer

> The new subdivision is in growth, where values often rise as it fills but competition from new supply can limit gains. The older neighborhood in revitalization may offer more house for the money and rising values as buyers restore homes, though conformity is less certain. Neither is always better; the buyer should compare recent sales trends in each and choose by need, not by assumption.

COMMON MISTAKES

- Treating value, price and cost as the same thing. Value is worth, price is what was paid, cost is what it took to build.
- Thinking contribution means the cost of an improvement. It means what the improvement adds to market value.
- Mixing up progression and regression. Progression helps the lesser property; regression hurts the better one.
- Assuming highest and best use is the current use or the most expensive imaginable use. It must be legally permissible, physically possible, financially feasible and maximally productive — tested in that order.
- Confusing plottage and assemblage. Assemblage is the act of combining parcels; plottage is the increase in value that results.
- Forgetting that market value assumes an arm's-length sale with typically motivated, informed parties and reasonable exposure.

> **Make it a game · Name That Principle.** Write the principles on cards — substitution, conformity, contribution, progression, regression, anticipation, plottage, competition, change, highest and best use, supply and demand — and spread them face up. The reader describes a situation: "The only two-story house on a street of ranches," "A coffee shop opens next to a busy one," "A pool that added less than it cost." First player to slap the right card keeps it. A wrong slap returns one card to the table. The player holding the most cards after fifteen situations wins and must recite DUST.

> **Scripture.** “Again, the kingdom of heaven is like unto a merchant man, seeking goodly pearls: Who, when he had found one pearl of great price, went and sold all that he had, and bought it.” (Matthew 13:45–46, KJV)
>
> The merchant in this parable knew pearls; he recognized true worth when he saw it and gladly paid everything for it. Appraisal is a small, earthly version of that skill — telling value from price and cost, and seeing what a thing is truly worth. The parable also reminds us that the greatest values are not measured in the market at all.

4.2 The Appraiser and the Appraisal

OBJECTIVES

- Explain how the savings-and-loan crisis led to FIRREA (1989), The Appraisal Foundation (1987) and USPAP.
- State FIRREA's rule for federally related transactions and describe the licensed, certified residential and certified general appraiser categories as a pattern.
- List the steps of the appraisal process, from defining the problem to the report, and distinguish the effective date of value from the report date.
- Distinguish an appraisal from a comparative market analysis, a broker price opinion and an automated valuation model, and say who may prepare each.
- Explain appraiser independence and the limits on what a real estate licensee may call an appraisal.

> **Warm-up.** Imagine you are a banker about to lend $400,000 on a house you have never seen, and the only person who will tell you what it is worth is the builder who wants the loan approved. In five minutes, write three rules you would want for the person who estimates the value. By the end of this lesson you will find that Congress wrote nearly the same rules in 1989.

WATCH

Secrets to Appraisals: Pass Your Real Estate Exam with Confidence!

Just Call Maggie · 10:51

https://www.youtube.com/watch?v=cOtsVClNSHc

> **WHEN TO WATCH**
> Watch after the third core idea; copy her appraisal-process steps in order, and pause on each practice question to answer it before she does.

BACKUP VIDEO

Real Estate Study CMA vs BPO vs Appraisal

LearntheGame · 7:52

https://www.youtube.com/watch?v=kLO-K81ZqME

Watch on practice day; make a three-column chart as you listen — CMA, BPO, appraisal — and fill in who prepares each and why.

appraisal

An unbiased, written opinion of a defined value of an adequately described property as of a specific date, supported by analysis of relevant data, prepared by a qualified appraiser.

appraiser

A person licensed or certified by a state to develop and communicate opinions of real property value.

USPAP

The Uniform Standards of Professional Appraisal Practice, the generally accepted ethical and performance standards for appraisers in the United States, issued by The Appraisal Foundation's Appraisal Standards Board.

The Appraisal Foundation

A nonprofit organization founded in 1987 and authorized by Congress through FIRREA to set appraisal standards (USPAP) and minimum appraiser qualifications.

FIRREA

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989, which among other things requires state-licensed or state-certified appraisers for federally related transactions above set thresholds.

federally related transaction

A real estate transaction that a federal financial institution regulator or agency engages in, contracts for or regulates, and that requires an appraisal under FIRREA.

effective date of value

The date as of which the appraiser's opinion of value applies, which may differ from the date the report is written.

comparative market analysis (CMA)

A licensee's comparison of recently sold, pending and active listings to help a seller set a list price or a buyer frame an offer; not an appraisal.

broker price opinion (BPO)

A licensee's estimate of a property's probable selling price, usually for a lender or investor deciding on a loss mitigation, sale or portfolio matter; not an appraisal.

automated valuation model (AVM)

A computer program that estimates value from public records and sales data using statistical models, without an inspection.

reconciliation

The final step of analysis in which the appraiser weighs the value indications from the approaches used to arrive at a final opinion of value.

appraiser independence

The rule that an appraiser must be free of influence or pressure from lenders, agents or parties to reach a predetermined value, and may not be paid contingent on the value reported.

CORE IDEAS

The story. In the early 1980s, savings and loan associations — the "thrifts" that had financed most American homes since the 1930s — were caught between the low fixed rates on their old mortgages and the high rates they now had to pay depositors. Many reached for growth with risky loans on commercial buildings, land and developments, and some of those loans rested on appraisals that valued projects far above anything the market would pay. When oil prices collapsed in the mid-1980s and real estate in the Southwest fell, the overvalued collateral was exposed. Between 1986 and 1995, federal regulators closed or otherwise resolved more than 1,000 savings institutions, and the cleanup cost taxpayers well over $100 billion. Investigators found many causes — weak supervision, fraud, bad bets — but inflated, unsupported appraisals were a thread through many failures. On August 9, 1989, Congress answered with the **Financial Institutions Reform, Recovery, and Enforcement Act** (FIRREA).

How they figured it out. The appraisal profession had already begun to reform itself. In 1986 nine leading appraisal organizations formed an ad hoc committee to write common standards, and in 1987 they created **The Appraisal Foundation** to own and maintain them as the **Uniform Standards of Professional Appraisal Practice** (**USPAP**). FIRREA's Title XI then gave the system the force of law. It required that appraisals for **federally related transactions** be performed in writing, under USPAP, by **state-licensed or state-certified appraisers.** It gave The Appraisal Foundation's

boards authority to set the standards (the Appraisal Standards Board) and the minimum qualifications for appraisers (the Appraiser Qualifications Board). And it created the federal **Appraisal Subcommittee** to oversee the states' licensing programs and keep a national registry of appraisers. Every state now licenses and disciplines its own appraisers under that framework.

The big idea. An **appraisal** is an unbiased opinion of a defined value (usually market value) of a described property, as of a specific **effective date**, for a stated intended use, developed and reported under USPAP by a qualified appraiser. Purposes vary: mortgage lending, sale or purchase, insurance, property-tax appeals, condemnation, estates, divorces and partnerships. The **appraisal process** follows a standard order: (1) **define the problem** — client, intended use, type of value, effective date, property and rights appraised; (2) determine the scope of work; (3) **collect and analyze data** — general data on the region and neighborhood, specific data on the site, the improvements and comparables; (4) analyze **highest and best use**; (5) value the land; (6) apply the **approaches to value** — sales comparison, cost and income; (7) **reconcile** the indications into a final opinion; and (8) **report** it. The effective date is the date the value applies to; a report written in June may value a house as of the April date of the inspection or, for an estate, as of a date of death.

States license appraisers in tiers that follow the national minimum criteria, and the exam tests the pattern rather than the hours. A **trainee** works under a supervising appraiser. A **licensed residential** appraiser may appraise noncomplex one-to-four-unit residential property up to value limits set by federal and state rules. A **certified residential** appraiser may appraise one-to-four-unit residential property without regard to value or complexity. A **certified general** appraiser may appraise all types of real property, including commercial and income property. Each tier requires education, experience and an examination, and every appraiser must follow USPAP, including its ethics rule and its **competency** rule — accept only assignments you can complete competently. Federal regulators set dollar thresholds below which some transactions may use other valuations; those figures change, so treat any number you see as an example and check the current rule. The **Appraisal Subcommittee** publishes a national registry where anyone can confirm an appraiser's credential.

Licensees estimate value too, and the exam wants the boundaries clear. A **comparative market analysis** (**CMA**) is a licensee's comparison of recently sold, pending and active listings to help a seller choose a list price or a buyer shape an

offer; it is a marketing tool, often free, and it is not an appraisal. A **broker price opinion** (**BPO**) is a licensee's estimate of probable selling price, typically prepared for a lender or investor deciding whether to approve a short sale, list a foreclosed property or value a loan portfolio; many states regulate BPOs, and they may not be used as the appraisal for a federally related mortgage loan. An **automated valuation model** (**AVM**) is a computer estimate from public records and sales data, with no inspection. A licensee who is not a licensed appraiser may not call a CMA or BPO an "appraisal," may not hold himself out as an appraiser, and may not perform appraisals for federally related transactions; doing so is unlicensed appraisal practice.

Independence is the moral center of appraisal law. USPAP requires the appraiser to act with impartiality, objectivity and independence, and forbids accepting an assignment in which the fee depends on reporting a predetermined value or a value that makes a loan close. Federal lending rules since the late 2000s go further: lenders, agents and borrowers may not pressure, coerce or bribe an appraiser toward a value, and lenders typically order appraisals through channels that separate the appraiser from the loan officer, often an **appraisal management company**. Under the Equal Credit Opportunity Act's valuation rule, a lender must give an applicant for a first-lien loan on a dwelling a free copy of every appraisal and written valuation promptly, and generally at least three business days before closing. Keep straight several kinds of "value" the exam names: **market value** (most probable price), **assessed value** (for taxes), **insurable value** (cost to replace the improvements for insurance) and **investment value** (worth to a particular investor).

On the exam today. Expect two or three items on the appraiser and the process. Know that FIRREA (1989) followed the savings-and-loan crisis and requires state-licensed or state-certified appraisers for federally related transactions; that USPAP is the standard, issued by The Appraisal Foundation (1987); and that the Appraisal Subcommittee oversees the state programs. Know the process order — define the problem first, reconcile and report last — and that an appraisal is an *opinion* of value as of an *effective date*. The traps: calling a CMA or BPO an appraisal; thinking a real estate licensee may appraise for a federally related loan; thinking the appraiser is the lender's advocate (the appraiser serves no one's interest but an honest opinion); thinking an appraiser's fee may depend on the value; confusing the report date with the effective date; and thinking assessed value equals market value. If a question

asks who issues USPAP, answer The Appraisal Foundation — not FIRREA, not the CFPB.

PICTURE STUDY



The Weigh House and the Crane on the Spaarne, Haarlem, Gerrit Adriaensz. Berckheyde, c. 1660–1698 · Oil on panel · Rijksmuseum, Amsterdam

Image: Wikimedia Commons, public domain

Gerrit Berckheyde was a painter of Haarlem who specialized in clear, quiet views of Dutch towns, painted with an almost architectural accuracy. Here he shows Haarlem's Waag, or weigh house, on the Spaarne river. In Dutch trading cities, goods unloaded from the barges were brought to the public weigh house, where sworn city weighmasters weighed them on official scales, so that buyer and seller, who distrusted each other, could both trust the number. The painting opens this lesson because an appraiser does the same work for land: an independent, sworn-to-standards measurement on which strangers can safely do business.

Look closely

- Find the weigh house — the stone building with the steep roof. Its scales belonged to the city, not to any merchant, which is why its weights could be trusted.
- Look at the crane and its great wooden wheel. Goods were lifted from the barges and carried straight to be weighed — measurement came before sale.
- Find the barrels and bales on the quay. Each would be recorded at an official weight before changing hands.

- Notice the tidy order of the scene. Berckheyde painted a town that ran on rules, records and trusted measures.

Talk about it

1. Why would a buyer and a seller both prefer the city's weighmaster to either one's own scale? How is that like FIRREA's rule for appraisers?
2. What would happen to trade on this quay if the weighmaster could be paid more for reporting heavier weights?
3. Proverbs 11:1 says a false balance is an abomination but a just weight is the Lord's delight. How is an inflated appraisal a false balance — and who is harmed by it?

PROJECT

Appraisal or Not? The Valuation Comparison Sheet

You will build a one-page comparison of the four ways value is estimated — appraisal, CMA, BPO and AVM — and then prepare a simple practice CMA for a pretend house using public sales data. You will also verify a real appraiser's credential on the national registry, the way a careful consumer or lender would.

You will need

- The Appraisal Subcommittee's website (asc.gov) and its national registry search
- Two free real estate websites or your county assessor's recent-sales data
- A calculator or spreadsheet
- Your exam notebook

Steps

1. Make a four-column table — Appraisal, CMA, BPO, AVM — with rows for Who prepares it, For whom, Inspection?, Governed by, and May it be used for a federally related loan?
2. On asc.gov, find the national registry and look up any appraiser credential in your state by city. Record the credential categories you see (licensed, certified residential, certified general) but no personal details.
3. Write the eight steps of the appraisal process in order, with one sentence each.
4. Practice CMA: pick a pretend 1,600-square-foot house in a neighborhood you know. Find three recent sales of similar homes nearby and record price and square footage.
5. Compute each comparable's price per square foot and apply the range to the subject.
6. Write a short paragraph explaining why your CMA is not an appraisal and what an appraiser would add.
7. Title the page "Appraisal or Not?", date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for FIRREA, USPAP, The Appraisal Foundation, Appraisal Subcommittee, federally related transaction, effective date, CMA, BPO and AVM.
2. Draw a timeline: early 1980s thrift troubles → 1986 ad hoc committee → 1987 Appraisal Foundation → August 9, 1989 FIRREA → state licensing of appraisers.
3. Write a five-line trap list titled "Appraisers," ending with: a CMA is NOT an appraisal, and a licensee is NOT an appraiser.

KEY FORMULAS

$$\text{CMA price per sq ft} = \frac{\text{sale price of comparable}}{\text{gross living area of comparable}}$$

$$\text{CMA estimate} = \text{subject gross living area} \times \text{typical price per sq ft}$$

From history. Modern American appraisal practice owes much to Frederick M. Babcock, an appraiser, teacher and author. As assistant administrator of the new Federal Housing Administration from 1934 to 1940, he built its system for appraising homes and underwriting insured mortgages — methods that spread through the lending industry. In 1932 appraisers had founded the American Institute of Real Estate Appraisers, an ancestor of today's Appraisal Institute, to train and credential the profession.

WORKED EXAMPLES

Example 1. Who may prepare which valuation? (a) A seller wants help choosing a list price. (b) A lender needs a value to approve a new purchase-money mortgage above the federal threshold. (c) A bank wants a quick estimate of probable sale price before approving a short sale. (d) A website shows an instant estimate of a home's value.

Show solution

1. (a) A licensee may prepare a **CMA** — a marketing analysis, not an appraisal.
2. (b) A federally related transaction requires an **appraisal** by a state-licensed or state-certified appraiser under USPAP.
3. (c) A licensee may prepare a **BPO** where state law allows, for the lender's loss-mitigation decision; it is not an appraisal.
4. (d) That is an **AVM**, a computer model with no inspection.

Answer: CMA by a licensee; appraisal by a licensed or certified appraiser; BPO by a licensee for a lender; AVM by a computer. Only the appraisal is an appraisal.

Example 2. In this example, a licensee prepares a CMA for a 1,850-square-foot house. Three recent sales nearby: 1,700 sq ft for $340,000; 1,900 sq ft for $374,300 ; 2,000 sq ft for $392,000. Estimate a list-price range from price per square foot.

Show solution

1. Comp 1: $\$340{,}000 \div 1{,}700 = \$200$ per sq ft.
2. Comp 2: $\$374{,}300 \div 1{,}900 = \$197$ per sq ft.
3. Comp 3: $\$392{,}000 \div 2{,}000 = \$196$ per sq ft.
4. Apply the range to the subject: $1{,}850 \times \$196 = \$362{,}600$ to $1{,}850 \times \$200 = \$370{,}000$.
5. A CMA also weighs condition, features, active listings and pending sales; price per square foot is only a starting point.

Answer: About $362,600 to $370,000 — a pricing range to discuss with the seller, not an appraisal.

Example 3. Exam style. Which law requires that appraisals for federally related transactions be performed by state-licensed or state-certified appraisers?

A. The Real Estate Settlement Procedures Act

B. The Truth in Lending Act

C. The Financial Institutions Reform, Recovery, and Enforcement Act

D. The Equal Credit Opportunity Act

Show solution

1. RESPA governs settlement disclosures and kickbacks; TILA governs credit-cost disclosures.
2. ECOA forbids discrimination in lending and gives applicants the right to copies of appraisals — but it does not license appraisers.
3. FIRREA (1989), Title XI, created the licensed/certified requirement after the savings-and-loan crisis.

Answer: C. FIRREA. Remember the chain: S&L crisis → FIRREA (1989) → state-licensed or certified appraisers under USPAP for federally related transactions.

PRACTICE

1. Easy What does USPAP stand for, and who issues it?

   Show answer

   The Uniform Standards of Professional Appraisal Practice, issued by the Appraisal Standards Board of The Appraisal Foundation.

2. Easy What event led Congress to pass FIRREA in 1989?

   Show answer

   The savings-and-loan crisis of the 1980s, in which more than a thousand thrifts failed, many with loans resting on inflated or unsupported appraisals.

3. Easy What is the first step of the appraisal process, and what is the last?

   Show answer

   First, define the problem (client, intended use, type of value, effective date, property and rights). Last, report the final opinion of value after reconciliation.

4. Medium A real estate licensee prepares a CMA for a seller and labels it "Appraisal of 412 Elm Street." What is wrong?

Show answer

A CMA is not an appraisal, and a licensee who is not a state-licensed or certified appraiser may not call it one or hold himself out as an appraiser.

5. Medium An appraiser inspects a house on March 3 and writes the report on March 20. What is the effective date of value, usually?

Show answer

March 3, the date as of which the opinion of value applies (normally the inspection date for a current-value assignment). March 20 is the report date.

6. Medium Which appraiser category may appraise a shopping center?

Show answer

A certified general appraiser. Licensed and certified residential appraisers are limited to residential property of one to four units.

7. Medium A loan officer tells an appraiser the house "needs to come in at $450,000 or the deal dies" and promises more work if it does. What rules does this violate?

Show answer

Appraiser independence rules under federal lending law and USPAP: no one may pressure an appraiser toward a predetermined value, and an appraiser may not accept work contingent on reporting a particular value.

8. Hard In this example, a 2,200-square-foot subject is compared with sales at $187, $190 and $193 per square foot. What CMA range results?

Show answer

$2{,}200 \times \$187 = \$411{,}400$ to $2{,}200 \times \$193 = \$424{,}600$.

9. Hard Distinguish a BPO from an appraisal in two sentences.

Show answer

A BPO is a licensee's estimate of probable selling price, usually for a lender or investor making a decision about a distressed property or portfolio. An appraisal is an opinion of a defined value developed under USPAP by a state-licensed or certified appraiser, and it is required for federally related transactions.

10. Hard A homeowner's assessed value is $310,000, and an appraisal for her refinance finds a market value of $365,000. Is one of them wrong? Explain.

Show answer

Not necessarily. Assessed value is set for taxation, often at a ratio of market value or by mass appraisal on a past date, while market value is the most probable current sale price; they serve different purposes and often differ.

11. Challenge A buyer applying for a first-lien mortgage asks whether she can see the appraisal. What does the ECOA valuation rule require?

Show answer

The lender must provide a free copy of all appraisals and written valuations promptly upon completion, and generally at least three business days before closing (a borrower may waive the timing, but not the copy).

12. Challenge Write three sentences explaining to a seller why the appraiser does not work for him, the buyer or the agent.

Show answer

The appraiser is hired to give an unbiased opinion of value under USPAP, usually for the lender's decision about the loan. Federal rules forbid anyone — the seller, the buyer, the agents or the loan officer — from pressuring the appraiser toward a number. That independence protects everyone, because a loan built on a false value can fail and harm the very people who pushed for it.

COMMON MISTAKES

- Calling a CMA or BPO an appraisal. Only a state-licensed or certified appraiser prepares an appraisal.
- Believing a real estate licensee may appraise for a federally related transaction. FIRREA requires a state-licensed or certified appraiser.
- Saying FIRREA or the CFPB writes USPAP. USPAP comes from The Appraisal Foundation's Appraisal Standards Board.
- Confusing the report date with the effective date of value.
- Treating the appraiser as the lender's or seller's advocate, or accepting a fee contingent on the value reported.
- Equating assessed value or insurable value with market value.

Make it a game · Appraisal or Not?. Each player makes four cards: APPRAISAL, CMA, BPO, AVM. The reader describes a valuation job: “a seller wants a list price,” “a lender approves a new mortgage,” “a bank weighs a short sale,” “a website’s instant estimate,” “an estate needs value as of the date of death,” “an agent emails a pricing packet.” Everyone flips a card at once; matching earns a point, and anyone who can also name the person allowed to prepare it earns a bonus. Twelve jobs; the winner recites the eight steps of the appraisal process in order.

Scripture. “A false balance is abomination to the LORD: but a just weight is his delight.” (Proverbs 11:1, KJV)

In Solomon’s day trade depended on scales, and a merchant who rigged his weights stole from every customer. An appraisal is a scale for land: lenders, buyers, sellers and taxpayers all rely on it. FIRREA and USPAP exist because false balances in the 1980s cost a nation dearly; the appraiser who reports the honest number, even when it kills a deal, keeps a just weight.

4.3 The Sales Comparison Approach

OBJECTIVES

- Select comparable sales that are recent, similar, nearby and arm's length, and explain why at least three are used.
- Name the elements of comparison — property rights, financing terms, conditions of sale, market conditions, location and physical features — and the order in which they are adjusted.
- Adjust a comparable's sale price toward the subject using the rule "comp better, subtract; comp worse, add," never adjusting the subject.
- Derive an adjustment by paired-sales analysis and a market-conditions adjustment by percentage.
- Complete a three-comparable adjustment grid and reconcile the adjusted prices into one indicated value, giving the most weight to the best comparable.

> **Warm-up.** Two houses on the same street look identical, but one has a two-car garage and sold for $318,000, and the other has none and sold for $306,000. In five minutes, write what the garage seems to be worth and how you could use that number to value a third house. You have just invented the appraiser's favorite tool.

WATCH

Sales Comparison Approach Real Estate | Real Estate Exam

The Real Estate Classroom · 15:00

https://www.youtube.com/watch?v=v3_PBJwGFTg

> **WHEN TO WATCH**
> Watch after the fourth core idea with your notebook open to a blank grid; copy his grid line by line and say aloud whether each adjustment is added or subtracted before he does.

BACKUP VIDEO

Sales Comparison Adjustments Paired Sales

Chris Ponsar, MAI · 9:02

https://www.youtube.com/watch?v=xJ0irDyTICE

An appraiser's own explanation of paired sales and adjustment grids — watch before the project and note how he derives an adjustment rather than guessing it.

KEY TERMS

sales comparison approach

An appraisal approach that estimates value by comparing the subject with similar properties that sold recently, adjusting each comparable's price for differences; also called the market data approach.

comparable (comp)

A recently sold property similar to the subject, used to indicate the subject's value.

elements of comparison

The categories in which comparables are adjusted: property rights conveyed, financing terms, conditions of sale, market conditions (time), location and physical characteristics.

conditions of sale

Circumstances of a sale that may make its price unrepresentative, such as a sale between relatives or a forced sale; such sales are usually rejected or adjusted.

paired-sales analysis

Deriving the value of a single feature by comparing the prices of two sales that are alike except for that feature.

subject property

The property being appraised.

adjustment

A dollar or percentage amount added to or subtracted from a comparable's sale price to account for a difference between it and the subject.

market conditions adjustment

An adjustment for changes in prices between a comparable's sale date and the effective date of the appraisal; also called a time adjustment.

seller concession

Value given by the seller to the buyer, such as paying the buyer's closing costs, that may inflate the recorded price and require a downward adjustment.

gross and net adjustment

Gross adjustment is the total of all adjustments without regard to sign; net adjustment is their sum with signs — both are used to judge how comparable a sale is.

reconciliation (in sales comparison)

Weighing the adjusted comparable prices — giving most weight to the most similar comparable, usually the one needing the fewest and smallest adjustments — to reach one indicated value.

CORE IDEAS

The story. In 1908 Sears, Roebuck and Company, already the country's great mail-order store, published its first catalog of houses. For the next three decades, a family in Ohio and a family in Oregon could choose the very same plan from the same page — the same rooms, the same windows, the same porch — and receive the lumber, nails, doors and shingles by railroad freight car. By most estimates Sears sold between 70,000 and 75,000 of these houses before the program closed around 1940, and other companies sold kit houses too. Today owners and historians still identify them by their floor plans. For an appraiser, they are a beautiful lesson. Two Sears houses built from one plan in the same year are as similar as two houses can be, yet they may sell for very different prices — one on a quiet street in a growing town, the other beside a rail yard in a town that lost its factory. The house is the same. The market, the location and the condition are not. Measuring exactly those differences is the sales comparison approach.

How they figured it out. Buyers have always priced houses by looking at what similar houses sold for — that is the principle of **substitution**. Appraisers turned the habit into a method by asking, for each difference, "how much does the market pay for this?" The cleanest answer comes from **paired-sales analysis**: find two sales alike in every way but one, and the difference in price measures that one feature. In this example, if two otherwise identical houses sold for $318,000 with a garage and $306,000 without, the market paid $12,000 for the garage. Repeated across many sales, such pairs give appraisers their adjustment values for bedrooms, baths, square footage, pools and time. The approach became the backbone of home appraisal as lenders adopted standard forms in the twentieth century, and it remains the most heavily weighted approach for single-family homes.

The big idea. The **sales comparison approach** (also called the **market data approach**) estimates the value of the **subject** from recent sales of similar properties,

the **comparables**. Good comps are **recent** (commonly within the last six months, rarely more than a year), **nearby** (the same neighborhood or market area), **similar** in size, age, style and quality, and **arm's length** — sales between unrelated, typically motivated parties. Only *closed* sales are comparables; active and pending listings show the direction of the market but did not sell. Appraisers use at least three comps. Then comes the rule the exam tests most: **adjust the comparable, never the subject**. If the comp is better than the subject in some feature, subtract the value of that feature from the comp's price; if the comp is worse, add. The memory aid is **CBS** — *comp better, subtract* (and comp poorer, add). Each adjusted price then tells what that comp would have sold for if it had been just like the subject.

The **elements of comparison** are adjusted in a customary order, transaction items first. **Property rights conveyed** (fee simple versus a leased fee). **Financing terms**: a sale with unusual seller financing, or with **seller concessions** such as paying the buyer's closing costs, may show a price above cash value, so the comp is adjusted down. **Conditions of sale**: sales between relatives, forced sales and many foreclosures are not arm's length and are usually rejected. **Market conditions** (time): if prices have risen since the comp sold, adjust it upward. In this example, a comp sold eight months ago for $340,000 in a market that has risen 4% since: $\$340{,}000 \times 0.04 = \$13{,}600$, giving a time-adjusted price of $353,600. Then the property items: **location** (a busy street, a view, a better school area) and **physical characteristics** — living area, bedrooms, baths, garage, lot size, age, condition, quality, pools and fireplaces.

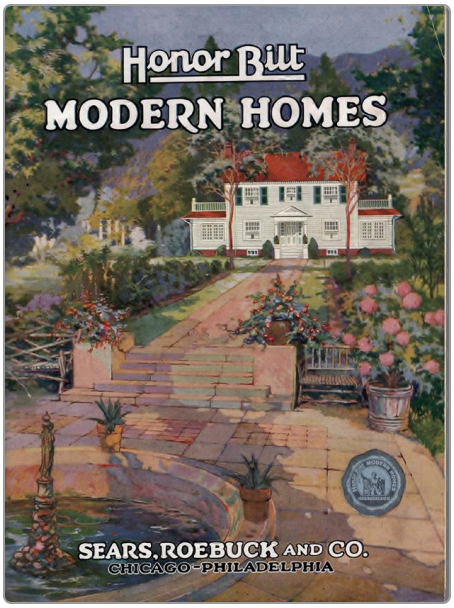
Walk through one grid. In this example, the subject has 1,800 square feet, two baths, a two-car garage, no fireplace and a quiet street. The market supports $80 per square foot of living area, $7,500 per bath, $5,000 per garage stall, $3,000 for a fireplace and $10,000 for a busy street. Comp A sold for $372,000; it has 100 more square feet (better, $-\$8{,}000$) and a fireplace (better, $-\$3{,}000$): adjusted $361,000. Comp B sold for $350,000; it has one bath (worse, $+\$7{,}500$) and sits on a busy street (worse, $+\$10{,}000$): adjusted $367,500. Comp C's time-adjusted price is $353,600; it has 50 fewer square feet (worse, $+\$4{,}000$) and a one-car garage (worse, $+\$5{,}000$): adjusted $362,600. The three adjusted prices now describe the same house — the subject — and fall in a tight range.

Reconciliation within the approach is judgment, not arithmetic averaging. The appraiser gives the most weight to the comp that is most similar — usually the one

with the fewest and smallest adjustments, measured by **gross adjustment** (all adjustments added without regard to sign) and **net adjustment** (the sum with signs). In the grid above, Comp A needed only $\$11{,}000$ of gross adjustment, Comp B $\$17{,}500$ and Comp C $\$22{,}600$ plus a time adjustment, so A deserves the most weight. Weighting A at 50% and B and C at 25% each gives $0.5(\$361{,}000) + 0.25(\$367{,}500) + 0.25(\$362{,}600) = \$363{,}025$, reconciled to about $\$363{,}000$. The sales comparison approach is the most reliable approach for single-family homes, condominiums and vacant land, where many similar sales occur; it is weakest for special-purpose properties such as churches or schools, which rarely sell, and in markets with few sales.

On the exam today. Expect one adjustment calculation and two or three concept items. The calculation almost always turns on the direction of the adjustment: **adjust the comparable, never the subject; comp better, subtract; comp worse, add.** Read slowly — the question may describe the *subject* as lacking a feature, which means the *comp* is better. Know the qualities of a good comp (recent, nearby, similar, arm's length, closed sale) and that sales between relatives or under duress are not arm's length. Know that time is adjusted first among the property-market items, and that seller concessions push the comp's price down. The traps: adding when the comp is better; adjusting the subject's value instead of the comp's price; using an active listing or a list price as a comparable; simply averaging the adjusted prices instead of weighting the best comp; and calling the sales comparison approach the best for a church, when the cost approach serves special-purpose property.

PICTURE STUDY



Honor Bilt Modern Homes (catalog cover), Sears, Roebuck and Co., 1922 · Color-printed catalog cover · Private collection

Image: Wikimedia Commons, public domain

From 1908 to about 1940, Sears sold houses by mail. Families chose a plan from a catalog like this one, and the precut lumber, millwork and hardware arrived by railroad car with instructions for assembly. Many of these houses still stand across the country. The catalog cover opens this lesson because it shows the idea behind the sales comparison approach in its purest form: the same house sold in many places — so that every difference in price between two of them comes not from the house, but from its location, its condition and its market.

Look closely

- Look at the house at the top of the walk. Sears offered dozens of plans, and families in different states built identical ones.
- Notice how much of the picture is garden, walk and setting. The catalog sold a way of life — and location and site still drive much of a house's value.
- Find the words "Honor Bilt." Quality grade was a selling point; appraisers still adjust for quality of construction.
- Think about the railroad that carried these kits. Shipping cost and local labor meant the same plan cost different amounts to build in different towns.

Talk about it

1. If two identical Sears houses sold for different prices in the same year, what elements of comparison would you investigate first?
2. Why must an appraiser adjust the comparable rather than the subject when the two houses differ?
3. Deuteronomy 25 forbids “divers weights, a great and a small.” How does using the same adjustment values for every comparable keep an appraisal honest?

PROJECT

The Three-Comp Adjustment Grid

You will build the sales comparison grid an appraiser uses — first in a spreadsheet that checks the lesson's worked example, then for a pretend subject using real recent sales from your area. This grid returns in the Unit 4 portfolio and again in Unit 10's math review.

You will need

- Free spreadsheet software (Google Sheets or LibreOffice Calc)
- Recent sales data from a free real estate website or your county assessor
- The Principles Field Guide from Lesson 4.1
- A calculator and your exam notebook

Steps

1. Set up columns for Subject, Comp A, Comp B and Comp C, and rows for sale price, market conditions, location, living area, baths, garage, other features, net adjustment, gross adjustment and adjusted price.
2. Enter the lesson's example (adjustment values $80 per square foot, $7,500 per bath, $5,000 per garage stall, $3,000 per fireplace, $10,000 for a busy street, 4% time on Comp C) and confirm the adjusted prices $361,000, $367,500 and $362,600.
3. Add a reconciliation row that weights the comps and confirm $363,025.
4. Now choose a pretend subject in your area and find three recent closed sales of similar homes. Record each sale's price, date, living area, baths and garage — but no owner names.
5. Using the lesson's example adjustment values (labeled as examples), adjust each comp toward your subject with the rule comp better, subtract; comp worse, add.
6. Compute gross and net adjustments for each comp and write two sentences on which comp deserves the most weight and why.

7. Reconcile to one value, title the page “Sales Comparison Grid,” date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, with a large card reading CBS — COMP BETTER, SUBTRACT; COMP POORER, ADD.
2. Draw a blank adjustment grid with rows in the customary order — rights, financing, conditions of sale, market conditions, location, physical — and keep it in your notebook as a template.
3. Write a five-line trap list titled “Sales comparison,” ending with: adjust the COMP, never the SUBJECT.

KEY FORMULAS

$$\text{Adjusted price} = \text{comp sale price} - \text{value of comp's superior features} + \text{value of comp's inferior features}$$

$$\text{Market conditions adjustment} = \text{comp sale price} \times \%\ \text{change since sale}$$

$$\text{Paired-sales adjustment} = \text{price with feature} - \text{price without feature}$$

$$\text{Gross adjustment } \% = \frac{\text{sum of all adjustments, ignoring sign}}{\text{comp sale price}} \times 100$$

From history. Sears’s first house catalog, the *Book of Modern Homes and Building Plans* of 1908, offered 44 designs priced from about $360 to $2,890 for the materials. A typical kit, as Sears and later historians describe it, arrived in a railroad boxcar holding some 30,000 parts — framing lumber cut to length, shingles, doors, windows, nails and paint — with a 75-page instruction book promising that a person of ordinary skill could assemble the house.

Example 1. In this example, the subject has three bedrooms, two baths and no pool. A comparable sold for $415,000; it has three bedrooms, two and a half baths and a pool. The market supports $6,000 for a half bath and $15,000 for a pool. What is the comp's adjusted price?

Show solution

1. Compare the comp to the subject, feature by feature.
2. Half bath: the comp has it, the subject does not — comp better, subtract $6,000.
3. Pool: comp better, subtract $15,000.
4. Adjusted price: $\$415{,}000 - \$6{,}000 - \$15{,}000 = \$394{,}000$.

Answer: $394,000 — what the comp would have sold for without its extra half bath and pool, that is, if it were like the subject.

Example 2. Complete the reconciliation. In this example, a subject is compared with three comps whose adjusted prices and gross adjustments are: Comp 1, $298,000 (gross $4,000); Comp 2, $306,000 (gross $26,000); Comp 3, $301,000 (gross $12,000). The appraiser weights them 60%, 10% and 30%. What is the indicated value?

Show solution

1. Most weight goes to Comp 1, the most similar (smallest gross adjustment); least to Comp 2.
2. Weighted contributions: $0.60 \times \$298{,}000 = \$178{,}800$; $0.10 \times \$306{,}000 = \$30{,}600$; $0.30 \times \$301{,}000 = \$90{,}300$.
3. Sum: $\$178{,}800 + \$30{,}600 + \$90{,}300 = \$299{,}700$.
4. A simple average would be $301,667 — giving the weakest comp equal say. Weighting is the better judgment.

Answer: About $299,700, reconciled to roughly $300,000.

Example 3. Exam style. In this example, the subject has a two-car garage. A comparable without a garage sold for $280,000. Paired sales show a two-car garage is worth $14,000 in this market, and prices have risen 2% since the comp sold. What is the comp's adjusted price?

A. $260,400

B. $271,600

C. $285,600

D. $299,600

Show solution

1. Market conditions first: $\$280{,}000 \times 1.02 = \$285{,}600$.
2. Garage: the comp lacks what the subject has — comp worse, ADD $14,000.
3. Adjusted: $\$285{,}600 + \$14{,}000 = \$299{,}600$.
4. B subtracts the garage (wrong direction) and C forgets it; A goes the wrong way on both.

Answer: D. $299,600. Comp worse, add — and adjust for time.

PRACTICE

1. Easy Name four qualities of a good comparable sale.

   Show answer

   Recent, nearby (same market area), similar to the subject, and an arm's-length closed sale.

2. Easy In the sales comparison approach, which property's price is adjusted — the subject's or the comparable's?

   Show answer

   The comparable's. The adjusted comp price shows what the comp would have sold for if it were like the subject.

3. Easy A comp has a fireplace; the subject does not. Do you add or subtract the fireplace's value, and from which price?

   Show answer

   Subtract it from the comp's sale price — the comp is better than the subject (comp better, subtract).

4. Medium In this example, a comp sold for $325,000 and lacks the subject's third bedroom, worth $12,000 in this market. It has a deck the subject lacks, worth $4,000. What is its adjusted price?

Show answer

Comp worse on the bedroom, add $12,000; comp better on the deck, subtract $4,000: $325,000 + $12,000 − $4,000 = $333,000.

5. Medium A house sold from a father to his daughter at a price well below market. Should it be used as a comparable?

Show answer

Generally no. A sale between relatives is not arm's length; its conditions of sale make the price unrepresentative of market value.

6. Medium In this example, a comp sold six months ago for $450,000 in a market where prices have risen 0.5% per month. What is the market conditions adjustment?

Show answer

Six months at 0.5% is 3%: $450,000 × 0.03 = $13,500, added because prices have risen. Time-adjusted price: $463,500.

7. Medium A comp sold for $390,000, but the seller paid $9,000 of the buyer's closing costs. How might an appraiser treat that?

Show answer

The concession may have inflated the price above a cash-equivalent value, so the appraiser typically adjusts the comp down, here by up to $9,000 to $381,000, depending on what the market shows.

8. Hard In this example, two nearly identical homes sold the same month: one with a finished basement for $362,000 and one without for $341,000. What does the market pay for the finished basement? What method is this?

Show answer

$362,000 − $341,000 = $21,000. This is paired-sales analysis.

9. Hard Comp X needed $3,000 of gross adjustments; Comp Y needed $31,000, with a net adjustment of only $1,000. Which deserves more weight, and why doesn't Y's small net adjustment make it the best?

Show answer

Comp X. Gross adjustment measures how different a comp is; Y's large plus and minus adjustments cancel in the net, but it still differs greatly from the subject, so its adjusted price is less reliable.

10. Hard Why is the sales comparison approach weak for valuing a church or a public school?

Show answer

Such special-purpose properties rarely sell, so few true comparables exist; the cost approach is usually more reliable for them.

11. Challenge In this example, subject: 2,000 sq ft, 3 baths, 2-car garage. Comp sold for $412,000 ten months ago with 2,150 sq ft, 2 baths, 3-car garage. Market rose 3% since the sale; $75 per sq ft; $9,000 per bath; $6,000 per stall. Find the adjusted price.

Show answer

Time: $\$412{,}000 \times 1.03 = \$424{,}360$. Size: comp 150 sq ft larger, subtract $11,250. Bath: comp worse, add $9,000. Garage: comp better, subtract $6,000. Adjusted: $\$424{,}360 - \$11{,}250 + \$9{,}000 - \$6{,}000 = \$416{,}110$.

12. Challenge A student averages three adjusted comp prices — $305,000, $309,000 and $331,000 — and reports $315,000. The third comp needed huge adjustments. Explain in three sentences what she should have done.

Show answer

Reconciliation is not a simple average; it weighs each comp by its reliability. The third comp needed the largest adjustments, so it is the least similar and should get the least weight. Weighting the first two heavily would put the value near $307,000, which better reflects the market evidence.

COMMON MISTAKES

- Adjusting the subject instead of the comparable. Always adjust the comp's sale price toward the subject.

- Going the wrong direction: when the comp is better, subtract; when the comp is worse, add. Read whether the stem describes the subject or the comp.
- Using active listings, list prices or pending sales as comparables. Only closed sales are comps; listings show the market's direction.
- Using non-arm's-length sales — between relatives, forced or under duress — without rejection or adjustment.
- Simply averaging adjusted prices instead of giving the most weight to the comp with the fewest and smallest adjustments.
- Forgetting market conditions (time) or seller concessions before adjusting physical features.

Make it a game · Comp Better, Subtract!. Write feature cards — pool, extra bath, larger lot, busy street, newer roof, one-car garage, view, fireplace — each with a dollar value. The reader names a subject ("three baths, no pool, quiet street"), then flips a card and says whether the COMP has more or less of it. Players shout ADD or SUBTRACT and the amount; the first correct shout scores. After eight cards, everyone computes the comp's adjusted price from a starting sale price of $300,000. Closest correct total wins, and the loser explains CBS aloud.

Scripture. "Thou shalt not have in thy bag divers weights, a great and a small. Thou shalt not have in thine house divers measures, a great and a small. But thou shalt have a perfect and just weight, a perfect and just measure shalt thou have: that thy days may be lengthened in the land which the LORD thy God giveth thee." (Deuteronomy 25:13–15, KJV)

A dishonest merchant kept two sets of weights — a heavy one for buying and a light one for selling. An appraiser who gives a garage $15,000 on one comp and $5,000 on another to reach a wanted number is doing the same thing. Consistent adjustments, drawn from the market and applied alike to every comp, are a just measure in the land.

4.4 The Cost Approach and Depreciation

OBJECTIVES

- State the cost approach formula and explain why land is valued separately and never depreciated.
- Distinguish reproduction cost from replacement cost and describe the square-foot, unit-in-place, quantity survey and index methods.
- Classify depreciation as physical deterioration, functional obsolescence or external (economic) obsolescence, and as curable or incurable.
- Compute accrued depreciation by the straight-line (age-life) method using effective age and economic life.
- Complete a cost-approach valuation and explain when the approach is most and least reliable, distinguishing appraisal depreciation from tax depreciation.

> **Warm-up.** Think of a house in your town built about forty years ago. In five minutes, list every reason it might be worth less than a brand-new copy of itself: things worn out, things out of style, and things outside its lot that the owner cannot control. Sort your list into three groups. You have just discovered the three kinds of depreciation.

WATCH

Cost Approach Real Estate | Real Estate Exam Prep Videos

The Real Estate Classroom · 9:01

https://www.youtube.com/watch?v=MkFArHGYiq8

> **WHEN TO WATCH**
> Watch after the third core idea; write his cost-approach formula at the top of a page and list each type of depreciation as he names it, with your own example beside it.

BACKUP VIDEO

3 Types of Obsolescence in Real Estate

US Realty Training · 5:09

https://www.youtube.com/watch?v=CZmkMp8YZEc

A quick second look at the three kinds of obsolescence — watch before the practice set and pause after each type to give your own example.

KEY TERMS

cost approach

An appraisal approach that estimates value as land value plus the depreciated cost of the improvements: land + (cost new − accrued depreciation).

reproduction cost

The cost to build an exact replica of the improvements, with the same materials, design and quality, at today's prices.

replacement cost

The cost to build improvements of equal utility using modern materials, design and standards at today's prices.

square-foot method

Estimating cost new by multiplying the building's area by a current cost per square foot for similar construction; the most common method.

unit-in-place method

Estimating cost new by pricing each component installed — foundation, framing, roof, plumbing — and adding them.

quantity survey method

The most detailed cost method, pricing every quantity of material and hour of labor plus overhead and profit, as a contractor bids a job.

accrued depreciation

The total loss in value of improvements from all causes, measured as the difference between cost new and present value.

physical deterioration

Loss in value from wear and tear, age and the elements; curable if the cost to fix is no more than the value it adds.

functional obsolescence

Loss in value from poor design, outdated features or layout that the market no longer wants; may be curable or incurable.

external (economic) obsolescence

Loss in value from causes outside the property, such as noise, traffic, nearby nuisances or a declining market; incurable by the owner.

effective age

The age a building appears to be given its condition and utility, which may be more or less than its actual (chronological) age.

economic life

The period over which improvements contribute to the property's value; remaining economic life is economic life minus effective age.

CORE IDEAS

The story. On March 17, 1930, construction began on the Empire State Building on Fifth Avenue in New York, and the crews worked with astonishing speed — at times more than four floors a week. The building opened on May 1, 1931, the tallest in the world, finished in a little over a year. Its total cost is usually given as about $41 million, land included. By any measure of *cost* it was a triumph. But the Great Depression had arrived while the steel went up, and when the doors opened, most of the office floors had no tenants. New Yorkers nicknamed it the "Empty State Building," and by most accounts it did not turn a profit until about 1950. Here was a brand-new building with no physical wear at all, built efficiently by skilled crews, whose market value fell far short of what it cost — because something outside the building, a collapsing economy, had cut into what people would pay to use it.

How they figured it out. The cost approach rests on the principle of **substitution**: an informed buyer will pay no more for a property than the cost of buying a similar lot and building an equally useful structure without delay. So appraisers estimate what it would cost to build the improvements new today, value the land separately by comparing land sales, and then subtract every reason the existing building is worth less than a new one. Those reasons — **depreciation** — fell into three families as appraisers studied them. Some loss comes from wear: roofs age, paint peels, foundations settle. Some comes from design the market no longer wants: one bathroom for five bedrooms, a dark kitchen, a bedroom you can reach only through another. And some, like the Empire State's empty floors, comes from forces beyond the property line. Each has a different cure, or none at all.

The big idea. The cost approach formula is value $=$ land $+$ (cost new $-$ accrued depreciation). The land is valued separately, usually by sales comparison, because **land does not depreciate** — only improvements wear out. Cost new comes in two kinds. **Reproduction cost** is the cost of an exact replica, same materials and craftsmanship — used for historic buildings and in some insurance work. **Replacement cost** is the cost of a building of equal *utility* with modern materials and

design — the usual choice for ordinary houses, since no one rebuilds plaster walls and knob-and-tube wiring. Appraisers estimate cost new by four methods: the **square-foot** method (area times a current cost per square foot — the most common); the **unit-in-place** method (pricing each installed component); the **quantity survey** method (every material and hour of labor, the most detailed and accurate, used by contractors); and the **index** method (original cost times a construction-cost index).

Accrued depreciation is the total loss in value from three causes, and the exam expects you to sort examples. **Physical deterioration** is wear and tear: worn carpet, peeling paint and an aging roof are *curable* if fixing them costs no more than the value it adds; a cracked foundation or rotted framing that would cost more to fix than it adds is *incurable*. **Functional obsolescence** is loss from design or features the market rejects: outdated fixtures or too few electrical outlets may be curable; a poor floor plan, a bedroom reached only through another bedroom, or ceilings too low for modern use are usually incurable. It also includes *superadequacies* — features that cost more than they add. **External obsolescence** (also called economic or environmental) comes from outside the property: a new highway interchange, airport noise, a nearby landfill, a plant closing, a recession. Because the owner cannot fix what lies beyond the lot line, external obsolescence is always treated as **incurable**.

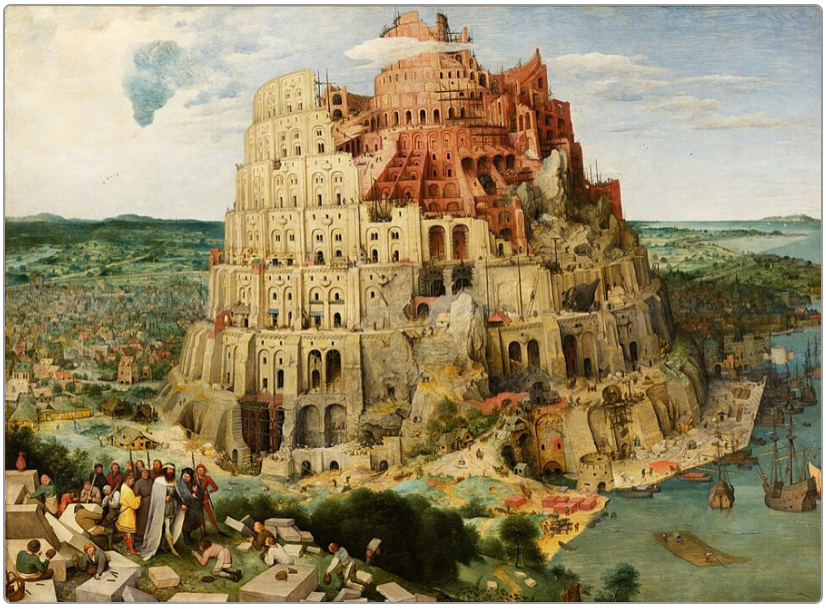
The simplest way to measure accrued depreciation is the **straight-line** or **age-life method**: the building loses an equal share of its value each year of its **economic life** — the years it contributes to value. Use **effective age**, the age the building appears given its condition, rather than its calendar age: a well-kept 30-year-old house might have an effective age of 15. In this example, a house with a replacement cost of $\$360{,}000$, an effective age of 10 years and a total economic life of 50 years has lost $10/50 = 20\%$, or $\$72{,}000$, leaving $\$288{,}000$ of depreciated cost. The annual rate is simply $1/50 = 2\%$ a year. Add the depreciated value of site improvements such as driveways and fences, then the land value, and the result is the indicated value by the cost approach. Remaining economic life — here $50 - 10 = 40$ years — tells a buyer how long the improvements should keep contributing.

Keep two kinds of "depreciation" apart. **Appraisal depreciation** is a real loss in market value, measured from the market. **Tax depreciation** (cost recovery) is an accounting deduction the tax law allows owners of income or business property: as of 2026, residential rental buildings are recovered over 27.5 years and nonresidential

buildings over 39 years, straight-line, and land is never depreciated. A rental house can lose tax basis every year while rising in market value. The cost approach is **most reliable** for new or nearly new buildings, where depreciation is small and easy to measure, and for **special-purpose properties** that rarely sell and produce no rent — churches, schools, hospitals, fire stations, government buildings and museums. It also underlies insurance estimates of replacement cost. It is **least reliable** for older buildings, where accrued depreciation becomes a large and uncertain guess, and in markets where buyers pay much more or much less than cost.

On the exam today. Expect one computation and two concept items. The computation: cost new (area times cost per square foot), minus straight-line depreciation (effective age ÷ economic life × cost new), plus land. Know the classifications cold: wear and tear is **physical**; poor design or outdated features are **functional**; anything off the property is **external** and always **incurable**. Know that **replacement** cost means equal utility with modern materials and **reproduction** means an exact replica, and that the quantity survey method is the most detailed. The traps: depreciating the land (never); adding depreciation instead of subtracting it; using actual age when the question gives effective age; calling a neighboring landfill functional obsolescence (it is external); calling external obsolescence curable; and choosing the cost approach for an older house or the sales comparison approach for a church. If the question mentions 27.5 or 39 years, it is asking about tax cost recovery, not appraisal.

PICTURE STUDY



The Tower of Babel, Pieter Bruegel the Elder, 1563 · Oil on oak panel · Kunsthistorisches Museum, Vienna

Image: Wikimedia Commons, public domain

Pieter Bruegel the Elder was the greatest Flemish painter of the sixteenth century, known for crowded scenes of ordinary work and village life. In 1563 he painted the story of Genesis 11 as if it were a construction site in his own Antwerp, filled with the cranes, treadwheels, scaffolds and quarrymen he could watch at any building in the city. The tower opens this lesson because it is the most famous picture of building cost ever painted: every block, ramp and laborer here has a price, and the whole enterprise shows how a structure can consume enormous cost without ever producing equal value.

Look closely

- Find the cranes and treadwheels. Bruegel painted the real building machinery of his day — the labor and equipment a quantity survey would price.
- Look at the upper tiers. The red brick core has not yet been faced with stone, while parts of the lower tiers already look weathered. Building and wear are happening at once.
- Study the foundation. The tower is built over a rocky outcrop, and its tiers lean subtly — Bruegel hints that the design itself is flawed.

- Find the king and the kneeling masons in the corner. The one who orders the building and the ones who pay for it in labor see it very differently.

Talk about it

1. Which kinds of depreciation can you find in this unfinished tower — physical, functional or even external?
2. Why might this tower's value be far less than its cost, even if it were finished? Which principle from Lesson 4.1 explains it?
3. Jesus spoke of a builder who "sitteth not down first, and counteth the cost" (Luke 14:28). What does Bruegel's tower teach about pride, planning and the honest count of cost?

PROJECT

The Cost Approach Worksheet

You will build a spreadsheet that values any house by the cost approach and test it on the lesson's examples. Then you will apply it to a real older house in your area, using the county assessor's public data for size and year built, and decide how far the cost approach can be trusted for it.

You will need

- Free spreadsheet software
- Your county assessor's parcel data (square footage, year built, land value)
- The lesson's example cost figures (treat any cost per square foot as an example)
- Your exam notebook and a calculator

Steps

1. Create inputs for living area, cost per square foot, garage area and cost, effective age, economic life, site improvements and land value.
2. Compute cost new, the depreciation percentage (effective age ÷ economic life), accrued depreciation, depreciated building value and total value.
3. Test the sheet: the first worked example must return $446,040 and the exam-style example $550,000.
4. Choose a real house in your area at least 40 years old. From the assessor's site, record its size, year built and assessed land value — no owner names.
5. Estimate an effective age based on its likely condition, and use an example cost per square foot of $175 and an economic life of 60 years. Run the sheet.
6. List one possible example of each kind of depreciation for that house and say whether each is curable.
7. Write three sentences on why the cost approach is weak for this older house and which approach you would weight instead. Title the page "Cost Approach Worksheet," date it, and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, plus a card pairing REPRODUCTION (exact replica) with REPLACEMENT (equal utility, modern materials).
2. Draw a depreciation tree: ACCRUED DEPRECIATION → PHYSICAL (curable / incurable), FUNCTIONAL (curable / incurable), EXTERNAL (incurable only), with two examples on each branch.
3. Write a five-line trap list titled “Cost approach,” ending with: LAND never depreciates; EXTERNAL obsolescence is never curable.

KEY FORMULAS

$$\text{Value} = \text{land value} + (\text{cost new} - \text{accrued depreciation}) \; [+\text{depreciated site improvements}]$$

$$\text{Cost new} = \text{building area} \times \text{cost per sq ft}$$

$$\text{Accrued depreciation (age-life)} = \frac{\text{effective age}}{\text{total economic life}} \times \text{cost new}$$

$$\text{Annual depreciation rate} = \frac{1}{\text{economic life}} = \frac{100\%}{\text{economic life}}$$

$$\text{Remaining economic life} = \text{economic life} - \text{effective age}$$

From history. Cost estimating grew into a profession in nineteenth-century Britain, where surveyors measured every quantity of brick, timber and labor in a design and published it as a “bill of quantities,” so that rival builders bid on exactly the same work. Their method lives on as the quantity survey. On June 15, 1868, forty-nine surveyors met at the Westminster Palace Hotel in London to found the Institution of Surveyors — today’s Royal Institution of Chartered Surveyors.

WORKED EXAMPLES

Example 1. In this example, a 2,000-square-foot house has a replacement cost of $180 per square foot, and its 480-square-foot garage costs $60 per square foot. The house has an effective age of 10 years and a total economic life of 50 years. Depreciated site improvements (driveway, fencing, landscaping) are worth $15,000, and comparable land sales indicate a land value of $120,000. Find the value by the cost approach.

Show solution

1. Cost new, house: $2{,}000 \times \$180 = \$360{,}000$. Garage: $480 \times \$60 = \$28{,}800$. Total: $\$388{,}800$.
2. Depreciation: $\dfrac{10}{50} = 20\%$; $0.20 \times \$388{,}800 = \$77{,}760$.
3. Depreciated cost of buildings: $\$388{,}800 - \$77{,}760 = \$311{,}040$.
4. Add site improvements and land: $\$311{,}040 + \$15{,}000 + \$120{,}000 = \$446{,}040$.

Answer: About $446,000. The land was added at full value — it is never depreciated.

Example 2. Classify each item as physical deterioration, functional obsolescence or external obsolescence, and as curable or incurable: (a) peeling exterior paint; (b) a cracked, settling foundation that would cost more to repair than it adds; (c) dated light fixtures and faucets; (d) a fourth bedroom reachable only through the third; (e) a new highway interchange beside the lot.

Show solution

1. (a) Wear from the elements — **physical, curable**: painting costs less than the value it restores.
2. (b) Wear that cannot economically be fixed — **physical, incurable**.
3. (c) Out-of-date features the market discounts but that are cheap to replace — **functional, curable**.
4. (d) A floor-plan flaw built into the structure — **functional, incurable** in most cases.
5. (e) A cause outside the property — **external, incurable**, always.

Answer: Physical curable, physical incurable, functional curable, functional incurable, external incurable. Ask: is it wear, design, or something beyond the lot line?

Example 3. Exam style. In this example, a building would cost $500,000 to replace new. It has an effective age of 12 years and an economic life of 60 years, and the land is worth $150,000. What is the indicated value by the cost approach?

A. $650,000

B. $550,000

C. $500,000

D. $400,000

Show solution

1. Depreciation: $\frac{12}{60} = 20\%$; $0.20 \times \$500{,}000 = \$100{,}000$.
2. Depreciated building: $\$500{,}000 - \$100{,}000 = \$400{,}000$.
3. Add land: $\$400{,}000 + \$150{,}000 = \$550{,}000$.
4. A ignores depreciation; D forgets the land; C depreciates the land along with the building.

Answer: B. $550,000 — land plus cost new minus depreciation.

PRACTICE

1. Easy Write the cost approach formula.

   Show answer

   Value = land value + (cost new − accrued depreciation), plus the depreciated value of any site improvements.

2. Easy Why is land valued separately and not depreciated?

   Show answer

   Land does not wear out or become obsolete in the way buildings do; it is valued by comparing land sales, and only the improvements are depreciated.

3. Easy Which cost method is the most detailed and accurate, pricing every material and hour of labor?

   Show answer

   The quantity survey method.

4. **Medium** An appraiser values an 1890s courthouse with hand-carved stone for an insurer that wants an exact replica rebuilt after a loss. Reproduction or replacement cost?

Show answer

Reproduction cost — an exact replica with the same materials and craftsmanship. Replacement cost would use modern materials of equal utility.

5. **Medium** Classify: a house sits next to a new 24-hour distribution center with constant truck traffic.

Show answer

External (economic) obsolescence — a cause outside the property — and therefore incurable by the owner.

6. **Medium** In this example, a building's economic life is 40 years. What is its annual straight-line depreciation rate, and how much of its cost new has been lost at an effective age of 14?

Show answer

Annual rate: $1/40 = 2.5\%$. At 14 years: $14 \times 2.5\% = 35\%$ of cost new.

7. **Medium** In this example, a 1,600-square-foot house costs $190 per square foot to replace. It is 25% depreciated, and the land is worth $95,000. Find the value.

Show answer

Cost new: $1{,}600 \times \$190 = \$304{,}000$. Depreciation: $76,000. Building: $228,000. Value: $\$228{,}000 + \$95{,}000 = \$323{,}000$.

8. **Hard** A 1975 house was completely renovated last year. Is its effective age likely to be more or less than its actual age? Why does it matter?

Show answer

Less. A thorough renovation makes the house function like a younger one; using effective age gives a smaller, more accurate depreciation than calendar age would.

9. Hard In this example, a building is now worth $252,000 after depreciating 2% a year for 15 years. What was its cost new?

Show answer

Fifteen years at 2% is 30% depreciation, so the building retains 70%: $\$252{,}000 \div 0.70 = \$360{,}000$.

10. Hard Why is the cost approach usually the best approach for a church but a weak one for a 60-year-old house?

Show answer

A church rarely sells and earns no rent, so sales and income data are lacking, while its cost can be estimated. For an old house, accrued depreciation is large and hard to measure, and plenty of comparable sales usually exist.

11. Challenge In this example, an investor buys a rental house for $400,000, of which $100,000 is land. What is the annual straight-line tax cost recovery, and why is it different from appraisal depreciation?

Show answer

Building basis $\$300{,}000 \div 27.5 \approx \$10{,}909$ per year (land is not depreciated). Tax depreciation is an accounting deduction set by statute; appraisal depreciation is an actual loss in market value, and the house may be rising in value while being depreciated for taxes.

12. Challenge Using the Empire State Building story, explain in three sentences why a brand-new building can be worth less than its cost.

Show answer

Cost measures what was spent; value measures what the market will pay. When the building opened in 1931, the Depression had cut demand for office space, so many floors stood empty and the income a buyer could expect fell short of the cost. That shortfall was external (economic) obsolescence — a loss from outside the property that no amount of good construction could cure.

COMMON MISTAKES

- Depreciating the land. Only improvements depreciate; land is added at its full value.
- Adding depreciation to cost new instead of subtracting it.

- Using actual (chronological) age when the problem gives effective age. Use effective age for age-life depreciation.
- Calling an off-site nuisance functional obsolescence. Anything outside the property line is external (economic) obsolescence, and it is always incurable.
- Mixing up reproduction cost (exact replica) and replacement cost (equal utility with modern materials).
- Confusing appraisal depreciation with tax cost recovery over 27.5 or 39 years.

Make it a game · Wear, Design or Outside?. Call out items quickly — cracked driveway, avocado-green bathroom, new landfill down the road, leaking roof, one bath for five bedrooms, noisy flight path, rotted sill plate, tiny closets, shuttered factory, peeling paint. Players hold up one finger for PHYSICAL, two for FUNCTIONAL, three for EXTERNAL; a correct call scores a point, and a bonus point goes to anyone who also calls CURABLE or INCURABLE correctly. Ten items per round, two rounds. The winner solves one quick age-life problem aloud: $300,000 cost new, 15 of 60 years, $80,000 land.

Scripture. “By much slothfulness the building decayeth; and through idleness of the hands the house droppeth through.” (Ecclesiastes 10:18, KJV)

The Preacher saw what every appraiser measures: buildings decay, and neglect hastens it. Physical deterioration is partly time and weather, but it is also stewardship. A house kept up has a younger effective age than its years, and the owner who mends the roof in season protects not only his family but the value entrusted to him.

4.5 The Income Approach

OBJECTIVES

- Build the income "stack" from potential gross income through vacancy and collection loss and other income to effective gross income and net operating income.
- Classify operating expenses as fixed, variable or reserves, and exclude debt service, depreciation and capital improvements from NOI.
- Apply the IRV formula (income = rate × value) to find value, the capitalization rate or the income, and explain why a higher cap rate means a lower value.
- Compute and apply a gross rent multiplier (monthly rent, one-to-four-unit residential) and a gross income multiplier (annual income, commercial).
- Reconcile the three approaches to value by weighting the approach most suited to the property type.

> **Warm-up.** Suppose an investor offers you a building that will hand you $10,000 of profit every year, forever, with no work. In five minutes, write the most you would pay for it and why. Would you pay $50,000? $100,000? $200,000? Whatever number you wrote, you just chose a capitalization rate — this lesson will show you which.

WATCH

Real Estate Math Video #14 - Capitalization Rate Real Estate (Cap Rate) | Real Estate Exam Prep

The Real Estate Classroom · 12:21

https://www.youtube.com/watch?v=ilEkOFoEwEg

> **WHEN TO WATCH**
> Watch after the fourth core idea with your calculator; draw the I-R-V circle as he does, and cover each answer to solve it first.

BACKUP VIDEO

Real Estate Math: Mastering The Gross Rent Multiplier | Just Call Maggie

Just Call Maggie · 15:52

https://www.youtube.com/watch?v=_tF_anPCc6E

Watch on practice day with your calculator; work every GRM problem before she reveals the answer, and note when she uses monthly versus annual rent.

KEY TERMS

income approach

An appraisal approach that estimates the value of income-producing property by converting its expected income into value; also called the income capitalization approach.

potential gross income (PGI)

The total annual income a property would produce if fully rented at market rent all year, before any vacancy.

vacancy and collection loss

The allowance subtracted from potential gross income for units expected to be vacant and rents expected to go uncollected.

effective gross income (EGI)

Potential gross income minus vacancy and collection loss, plus other income such as laundry, parking or storage fees.

operating expenses

The costs of running the property: fixed expenses (property taxes, insurance), variable expenses (utilities, repairs, management, supplies) and reserves for replacement.

reserves for replacement

An annual allowance set aside for replacing short-lived components such as roofs, appliances and carpets.

net operating income (NOI)

Effective gross income minus operating expenses; it excludes debt service (mortgage payments), tax depreciation and capital improvements.

capitalization rate (cap rate)

The rate used to convert NOI into value, equal to NOI divided by value; derived from comparable sales and reflecting risk.

IRV

The capitalization formula: income = rate × value, so value = income ÷ rate and rate = income ÷ value.

gross rent multiplier (GRM)

A factor equal to sale price divided by monthly gross rent, used for one-to-four-unit residential property.

gross income multiplier (GIM)

A factor equal to sale price divided by annual gross income, used for commercial and larger income property.

reconciliation (of approaches)

The appraiser's weighing of the value indications from the sales comparison, cost and income approaches, giving most weight to the approach most applicable to the property.

CORE IDEAS

The story. On June 6, 1889, a pot of glue boiled over in a woodworking shop on Seattle's waterfront, and by nightfall the city's entire business district lay in ashes. Seattle rebuilt fast and rebuilt in brick and stone, and on the corner of Pioneer Place the city's founding businessman, Henry Yesler, raised a six-story office block designed by the architect Elmer Fisher. The Pioneer Building was finished in 1892, the year Yesler died. Five years later, on July 17, 1897, the steamship *Portland* docked in Seattle carrying miners from the Yukon and well over a ton of gold, and the Klondike Gold Rush began. Tens of thousands of prospectors passed through Seattle buying outfits, and mining companies scrambled for offices — the Pioneer Building housed dozens of them in the years that followed. To an investor deciding what such a building was worth, its brick and its handsome arches mattered far less than one number: how much rent its offices would bring in, year after year.

How they figured it out. The principle behind the income approach is **anticipation**: value is the present worth of expected future benefits. In 1906 the Yale economist Irving Fisher set the idea down in *The Nature of Capital and Income*: the value of any capital asset is its expected stream of future income, discounted to the present. A building is worth what its future rents are worth today. Appraisers and investors turned this into a working tool called **capitalization**. They measured a property's yearly **net operating income**, observed what similar buildings sold for, and computed the ratio of income to price — the **capitalization rate**. Divide any building's income by the market's rate, and you have its value. The method spread with the growth of office and apartment investment in the twentieth century, and simpler rules of thumb — the gross rent and gross income multipliers — grew up beside it for smaller properties.

The big idea. The income approach builds a "stack." Start with **potential gross income** (PGI): every unit rented at market rent for the whole year. Subtract **vacancy and collection loss**. Add **other income** — laundry, parking, storage. The result is

effective gross income (EGI). Subtract **operating expenses: fixed** expenses that do not change with occupancy (property taxes, insurance), **variable** expenses that do (utilities, repairs, maintenance, management, supplies) and **reserves for replacement** for roofs, appliances and carpets. The result is **net operating income** (NOI). Three things are *never* operating expenses: **debt service** (mortgage principal and interest — it depends on the buyer's financing, not the property), **tax depreciation** (an accounting deduction, not a cash cost) and **capital improvements**. Finally, capitalize: $V = I \div R$.

Walk through one apartment building. In this example, 12 units rent for $1,500 a month: PGI is $12 \times \$1{,}500 \times 12 = \$216{,}000$. Vacancy and collection loss at 5% is $10,800, and laundry brings $3,600, so EGI is $\$216{,}000 - \$10{,}800 + \$3{,}600 = \$208{,}800$. Operating expenses: taxes $24,000, insurance $6,000, utilities $9,600, repairs and maintenance $12,000, management $12,000 and reserves $6,000, a total of $69,600. NOI is $\$208{,}800 - \$69{,}600 = \$139{,}200$. The owner's mortgage payments of $96,000 a year are left out entirely. If similar buildings sell at an 8% cap rate, the value is $\$139{,}200 \div 0.08 = \$1{,}740{,}000$.

The **IRV** formula has three forms, and the exam may ask for any of them: $I = R \times V$, $V = I \div R$ and $R = I \div V$. Many students draw a circle with I on top and R and V below: cover the unknown, and the circle shows whether to multiply or divide. The cap rate comes from the market. In this example, three comparable buildings sold with NOIs and prices of $120,000 on $1,500,000 (8.0%), $78,000 on $1,000,000 (7.8%) and $162,000 on $2,000,000 (8.1%), supporting about 8%. Notice the inverse relationship: the same $139,200 NOI is worth about $1,988,571 at 7% and about $1,546,667 at 9%. A **higher cap rate means a lower value**, because buyers demand a higher return from riskier property. A small change in the rate makes a large change in value, which is why appraisers derive it carefully from sales.

Smaller rentals use a shortcut. The **gross rent multiplier** (GRM) is sale price divided by *monthly* gross rent and is used for one-to-four-unit residential property. In this example, three rented houses sold for $360,000 at $2,000 a month, $342,000 at $1,900 and $378,000 at $2,100 — each a GRM of 180. A similar house renting for $2,050 is worth about $180 \times \$2{,}050 = \$369{,}000$. The **gross income multiplier** (GIM) uses *annual* gross income and serves commercial and larger properties: a building with $225,000 of annual gross income in a market with a GIM of 8 indicates $1,800,000. Multipliers ignore expenses, so they are rough. Finally, **reconciliation** weighs the

three approaches by how well each fits the property — sales comparison for houses, income for apartments and offices, cost for new or special-purpose buildings. It is a judgment, never a simple average.

On the exam today. Expect two calculations and a concept item. The calculations: build NOI correctly and divide by the cap rate; or find a cap rate as NOI ÷ price; or apply a GRM to monthly rent. Know the order of the stack — PGI, minus vacancy and collection loss, plus other income, equals EGI; minus operating expenses equals NOI — and that the income approach is most reliable for **income-producing property** such as apartments, offices and stores. The traps are classic: subtracting **mortgage payments** or **depreciation** as operating expenses (never); capitalizing gross income instead of NOI; forgetting vacancy; using annual rent with a GRM (GRM uses monthly rent; GIM uses annual); thinking a higher cap rate means a higher value (it means a lower one); and averaging the three approaches instead of reconciling them by applicability. When the circle gives you trouble, ask: is the unknown on top (multiply) or on the bottom (divide)?

PICTURE STUDY



The Pioneer Building, Seattle, Unknown photographer, c. 1900 · Photograph, published as a halftone in the souvenir booklet *Seattle and the Orient* · Published in Seattle, 1900; public domain

Image: Wikimedia Commons, public domain

This photograph appeared in a 1900 souvenir booklet that promoted Seattle as the gateway to Alaska and Asia. It shows the Pioneer Building, built in 1889–92 after the Great Seattle Fire and still standing in Pioneer Square today as a National Historic Landmark. Its offices filled with mining companies, banks and professionals during the Klondike years. It opens this lesson because a building like this was bought and sold for its income: every arched window was an office, every office a rent, and the sum of those rents, less the cost of running the building, decided what it was worth.

Look closely

- Count the floors and the windows. Each office behind them was a source of rent — the potential gross income of the building.
- Read the street-level signs: a bank, a furrier. Ground-floor shops often paid the highest rents because of their foot traffic.
- Find the horse and buggy and the overhead wires. Seattle was changing fast in 1900, and anticipation of growth drove investment downtown.
- Notice the solid brick and stone. After the 1889 fire, durable construction cut fire risk — and with it insurance, a fixed operating expense.

Talk about it

1. If half these offices stood empty, which line of the income stack would change, and how would the building's value respond?
2. Why would a buyer of this building care more about its rent roll than about what it cost Henry Yesler to build?
3. Proverbs 27:23 says, "Be thou diligent to know the state of thy flocks." How does an honest income statement help an owner know the state of his building, and why does the next verse warn that riches are not forever?

PROJECT

The Income Property Analysis

You will build an investor's one-page analysis of a pretend apartment building — the income stack, the cap-rate valuation, a sensitivity table and a GRM check — and test it against the lesson's examples. Use clearly labeled example figures, and you may check current local rents on a public listing site for realism.

You will need

- Free spreadsheet software
- A public rental-listing website for your area (for typical rents only)
- The lesson's formulas and worked examples
- Your exam notebook and a calculator

Steps

1. Set up the stack: units, monthly rent, PGI, vacancy and collection loss %, other income, EGI, each operating expense on its own line, total operating expenses and NOI.
2. Add a line for annual mortgage payments BELOW NOI and label it "not an operating expense — for cash-flow only."
3. Test the sheet with the lesson's 12-unit example: NOI must be $139,200 and value $1,740,000 at an 8% cap rate.
4. Create a sensitivity table showing value at cap rates of 6%, 7%, 8%, 9% and 10%, and write one sentence about the pattern.
5. Now model a pretend 8-unit building in your town using typical local rents, a 5% vacancy allowance and expenses equal to about 35–40% of EGI (an example ratio). Find NOI and value at 7.5%.
6. Add a GRM check: compute what a 4-unit version would be worth at a GRM of 150 applied to its total monthly rent, and compare.
7. Title the page "Income Property Analysis," date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every term, plus a large card with the I-R-V circle and the three versions of the formula.
2. Draw the income stack as a staircase: PGI → − vacancy & collection loss → + other income → EGI → − operating expenses → NOI → ÷ cap rate → VALUE. Write "NOT debt service, NOT depreciation" beside the expense step.
3. Write a five-line trap list titled "Income approach," ending with: HIGHER cap rate = LOWER value.

KEY FORMULAS

$$\text{PGI} = \text{units} \times \text{monthly rent} \times 12$$

$$\text{EGI} = \text{PGI} - \text{vacancy and collection loss} + \text{other income}$$

$$\text{NOI} = \text{EGI} - \text{operating expenses (fixed} + \text{variable} + \text{reserves)}$$

$$I = R \times V \qquad V = \frac{I}{R} \qquad R = \frac{I}{V}$$

$$\text{GRM} = \frac{\text{sale price}}{\text{monthly gross rent}} \qquad \text{Value} = \text{GRM} \times \text{monthly rent}$$

$$\text{GIM} = \frac{\text{sale price}}{\text{annual gross income}}$$

From history. After the 1889 fire, Seattle did more than rebuild in brick. The city raised the streets of the old business district by roughly one to two stories to fix drainage and tides, and for years shoppers climbed ladders between the new sidewalks and the old storefronts below. Many original ground floors were left beneath the new streets, and today's guided tours of "Underground Seattle" in Pioneer Square walk through them, a few steps from the Pioneer Building.

Example 1. In this example, a 20-unit apartment building rents each unit for $1,250 a month. Vacancy and collection loss is 6% of potential gross income; parking brings $6,000 a year. Operating expenses are $118,000. The owner's annual mortgage payments are $140,000. Comparable sales indicate a 7.5% cap rate. Find NOI and value.

Show solution

1. PGI: $20 \times \$1{,}250 \times 12 = \$300{,}000$.
2. Vacancy and collection loss: $0.06 \times \$300{,}000 = \$18{,}000$.
3. EGI: $\$300{,}000 - \$18{,}000 + \$6{,}000 = \$288{,}000$.
4. NOI: $\$288{,}000 - \$118{,}000 = \$170{,}000$. The mortgage payments are debt service — ignore them.
5. Value: $\$170{,}000 \div 0.075 = \$2{,}266{,}667$.

Answer: NOI is $170,000; value is about $2,267,000.

Example 2. Exam style. In this example, an investor is analyzing a small office building. Annual effective gross income is $180,000. The owner reports: property taxes $18,000, insurance $5,000, maintenance and utilities $22,000, management $9,000, reserves $4,000, mortgage interest $41,000 and tax depreciation $20,000. What is the NOI?

A. $61,000

B. $81,000

C. $122,000

D. $126,000

Show solution

1. Operating expenses include taxes, insurance, maintenance and utilities, management and reserves.
2. Total operating expenses: $\$18{,}000 + \$5{,}000 + \$22{,}000 + \$9{,}000 + \$4{,}000 = \$58{,}000$.
3. Exclude mortgage interest (debt service) and depreciation (not an operating expense).
4. NOI: $\$180{,}000 - \$58{,}000 = \$122{,}000$. A subtracts everything; B subtracts the interest but not depreciation; D forgets reserves.

Answer: C. $122,000 — never subtract debt service or depreciation.

Example 3. Exam style. In this example, three single-family rentals recently sold: $315,000 renting for $1,800 a month; $332,500 renting for $1,900; and $341,250 renting for $1,950. A similar house rents for $1,850 a month. What is its indicated value?

A. $323,750

B. $333,000

C. $388,500

D. $3,885,000

Show solution

1. GRMs: $\$315{,}000 \div \$1{,}800 = 175$; $\$332{,}500 \div \$1{,}900 = 175$; $\$341{,}250 \div \$1{,}950 = 175$.
2. Apply to the subject's monthly rent: $175 \times \$1{,}850 = \$323{,}750$.
3. D multiplies by annual rent — the GIM mistake — and is absurd for this house.

Answer: A. $323,750. GRM uses monthly rent and suits one-to-four-unit homes.

PRACTICE

1. Easy Write the three forms of the IRV formula.

   Show answer

   Income = rate × value; value = income ÷ rate; rate = income ÷ value.

2. Easy Name two items that are NEVER included in operating expenses when computing NOI.

   Show answer

   Any two of: debt service (mortgage principal and interest), tax depreciation, capital improvements, and the owner's income taxes.

3. Easy Does a GRM use monthly or annual rent? For what kind of property?

   Show answer

   Monthly gross rent, for one-to-four-unit residential property. The GIM uses annual gross income for commercial and larger properties.

4. **Medium** In this example, a property's NOI is $84,000 and the market cap rate is 7%. What is its value?

   Show answer

   $84,000 \div 0.07 = \$1,200,000$.

5. **Medium** In this example, a building sold for $2,400,000 with an NOI of $180,000. What cap rate does the sale indicate?

   Show answer

   $\$180,000 \div \$2,400,000 = 0.075$, or 7.5%.

6. **Medium** In this example, a 10-unit building rents at $1,400 per unit per month, with 5% vacancy and collection loss and no other income. Find PGI and EGI.

   Show answer

   PGI: $10 \times \$1,400 \times 12 = \$168,000$. Vacancy: $8,400. EGI: $159,600.

7. **Medium** Classify each as a fixed expense, a variable expense, a reserve, or not an operating expense: property taxes; water and sewer; a fund for future roof replacement; mortgage interest; property management fee.

   Show answer

   Property taxes — fixed. Water and sewer — variable. Roof fund — reserves for replacement. Mortgage interest — not an operating expense (debt service). Management fee — variable.

8. **Hard** In this example, an investor wants a 9% return on a property with an NOI of $45,000. What is the most she should pay? If she accepted 8% instead, what could she pay?

   Show answer

   At 9%: $\$45,000 \div 0.09 = \$500,000$. At 8%: $\$45,000 \div 0.08 = \$562,500$. Accepting a lower rate means paying a higher price.

9. **Hard** In this example, a duplex rents for $1,600 per side per month, and the market GRM is 140. What is its indicated value?

   Show answer

   Total monthly rent $3,200; value $140 \times \$3,200 = \$448,000$.

10. Hard For a single-family home, the approaches indicate: sales comparison $412,000, cost $430,000, income (GRM) $398,000. How should the appraiser reconcile, and roughly where should the final value fall?

Show answer

Give the most weight to the sales comparison approach, which is most reliable for single-family homes with an active market; the final value should fall at or very near $412,000. The simple average, $413,333, happens to be close here, but averaging is not the method.

11. Challenge In this example, a building's EGI is $260,000 and its operating expense ratio is 40%. Market cap rates are 6.5%. Find NOI and value; then find how much value is lost if the cap rate rises to 7.5%.

Show answer

Expenses: $0.40 \times \$260{,}000 = \$104{,}000$; NOI: $156,000. Value at 6.5%: $2,400,000; at 7.5%: $2,080,000. Loss: $320,000 from a one-point rise in the rate.

12. Challenge A seller says, "My building earns $200,000 a year, so at an 8% cap rate it's worth $2.5 million." His $200,000 is gross rent, and his mortgage payments are $110,000. Write three sentences correcting him.

Show answer

A cap rate must be applied to net operating income, not gross rent, so first subtract vacancy and collection loss and the operating expenses. His mortgage payments are debt service and are not subtracted at all, because value belongs to the property regardless of how any buyer finances it. If, for example, his NOI is $130,000, the value at 8% is about $1,625,000 — far less than $2.5 million.

COMMON MISTAKES

- Subtracting mortgage payments (debt service) or tax depreciation as operating expenses. NOI excludes both.
- Capitalizing gross income instead of net operating income.
- Forgetting vacancy and collection loss, or adding other income before subtracting vacancy from PGI.

- Using annual rent with a GRM. A GRM uses monthly rent; a GIM uses annual income.
- Believing a higher cap rate means a higher value. Value and cap rate move in opposite directions.
- Averaging the three approaches. Reconciliation gives the most weight to the approach most suited to the property.

Make it a game · The I-R-V Race. Draw the I-R-V circle on a big card in the middle of the table. The reader calls out two of the three numbers — "NOI $60,000, rate 8%," "value $900,000, NOI $72,000," "value $500,000, rate 6%" — and players race to give the third. First correct answer wins the round. Mix in trap cards: a mortgage payment to ignore, a gross-rent figure that must be netted first, a GRM with annual rent. Calling the trap before answering earns a bonus point. First to ten points wins and explains why a higher cap rate means a lower value.

Scripture. "Be thou diligent to know the state of thy flocks, and look well to thy herds. For riches are not for ever: and doth the crown endure to every generation?" (Proverbs 27:23–24, KJV)

The shepherd who knows his flock — how many, how healthy, what they need — is the ancient picture of an owner who reads his income statement honestly. The income approach asks exactly that: what does this property truly earn, after every real cost? And the proverb's warning fits too: rents and cap rates change, so wise owners keep reserves and never assume that today's income will last forever.

UNIT 4

Valuation

In 1989 Congress rewrote the rules for every appraiser in America because a generation of bad estimates of value had helped bring down more than a thousand savings institutions. Value is that important. This unit teaches you to think about worth the way appraisers, lenders and the national exam do. You will separate **value** from **price** and **cost**, define **market value** precisely, and learn the principles — **substitution**, **highest and best use**, **conformity**, **contribution**, **progression** and **regression** — that explain why one house is worth more than another. You will meet the appraiser, the **USPAP** standards and the federal law that licenses appraisers, and learn why a licensee's **CMA** or **BPO** is not an appraisal.

Then you will do the work itself, three ways. In the **sales comparison approach** you will adjust comparable sales toward the subject — comp better, subtract; comp worse, add — and reconcile a three-comp grid. In the **cost approach** you will price a building new, subtract physical, functional and external **depreciation**, and add the land. In the **income approach** you will build net operating income from gross rents and capitalize it with a **cap rate**, and you will value small rentals with a **gross rent multiplier**. This is a math-heavy unit: keep a calculator beside your notebook, show every step, and check each answer by asking whether it makes sense for a real house on a real street.

PREREQUISITES

- Can compute percents, percent change and simple ratios, and solve a one-step equation for an unknown ($I = R \times V$ for V)
- Can compute area in square feet and multiply area by a cost per square foot
- Can explain the four powers of government and why zoning limits what can be built on a lot (Unit 3)
- Has the exam notebook current, with Unit 3's property-tax chain and the difference between assessed value and market value

MASTERY CHECKLIST

- ☐ I can distinguish value, price and cost, state the elements of market value, and name the four characteristics of value (DUST) and the four forces.
- ☐ I can define and apply the principles of value and test highest and best use in the correct order.
- ☐ I can explain FIRREA, USPAP and The Appraisal Foundation, list the steps of the appraisal process, and tell an appraisal from a CMA, BPO or AVM.
- ☐ I can select arm's-length comparables and adjust them toward the subject using comp better, subtract; comp worse, add — including time and concessions.
- ☐ I can complete and reconcile a three-comp adjustment grid, weighting the comp with the fewest and smallest adjustments.
- ☐ I can value a property by the cost approach, classify depreciation as physical, functional or external and curable or incurable, and compute age-life depreciation.
- ☐ I can build NOI from potential gross income, exclude debt service and depreciation, and solve any form of the IRV formula.
- ☐ I can compute and apply a GRM and a GIM and reconcile the three approaches by the property type.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **The Appraisal Foundation: USPAP**: Free, official. The home of the Uniform Standards of Professional Appraisal Practice, with a free online version of the current edition. Skim its Ethics and Competency rules during Lesson 4.2. Ages 15 and up.
- **Appraisal Subcommittee (ASC)**: Free, official. The federal agency created by FIRREA to oversee state appraiser licensing; its national registry lets anyone confirm an appraiser's credential. Used in the Lesson 4.2 project. Ages 15 and up.
- **CFPB: What are appraisals and why do I need to look at them?**: Free, official. The Consumer Financial Protection Bureau's plain explanation of home appraisals for borrowers. Read it with Lesson 4.2. Ages 14 and up.
- **CFPB: Do I have the right to receive a copy of my home appraisal?**: Free, official. Explains the federal rule that gives mortgage applicants free copies of appraisals and valuations before closing. Use it for the Lesson 4.2 extension. Ages 14 and up.
- **FHFA House Price Index**: Free, official. The Federal Housing Finance Agency's index of home-price changes by state and metro area. Use it in Lesson 4.3 to see how appraisers support a market-conditions (time) adjustment. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

4.1	**What Makes Value**	3 sessions of 50 minutes
4.2	**The Appraiser and the Appraisal**	3 sessions of 50 minutes
4.3	**The Sales Comparison Approach**	3 sessions of 50 minutes
4.4	**The Cost Approach and Depreciation**	3 sessions of 50 minutes
4.5	**The Income Approach**	3 sessions of 50 minutes

Unit 4 Test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a

timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Seventy percent (14 of 20) matches the common passing line, but aim higher. Figures marked “in this example” are examples — real adjustment values, construction costs and cap rates vary by market and year. Choose the one BEST answer, and show your arithmetic on scratch paper.

1. **5 pts**

   The four characteristics a property must have to have value are:

   A. Demand, utility, scarcity and transferability

   B. Location, size, age and condition

   C. Supply, demand, cost and price

   D. Physical, economic, governmental and social

2. **5 pts**

   The largest and most expensive house on a street of modest homes is likely to be worth less than an identical house in a neighborhood of similar homes. This illustrates:

   A. Progression

   B. Substitution

   C. Regression

   D. Plottage

3. **5 pts**

   In analyzing highest and best use, which test is applied FIRST?

   A. Maximally productive

   B. Legally permissible

   C. Financially feasible

   D. Physically possible

4. **5 pts**

   In this example, an owner spends $40,000 on an in-ground pool, and appraisers find it adds $15,000 to market value. Which principle explains the difference?

   A. Anticipation

   B. Competition

   C. Conformity

   D. Contribution

5. 5 pts

A developer buys three adjoining lots and combines them into one site worth more than the three lots separately. The increase in value is called:

A. Assemblage

B. Plottage

C. Progression

D. Accretion

6. 5 pts

Following the savings-and-loan crisis, which law requires state-licensed or state-certified appraisers for federally related transactions?

A. FIRREA (1989)

B. RESPA (1974)

C. TILA (1968)

D. The Fair Housing Act (1968)

7. 5 pts

The Uniform Standards of Professional Appraisal Practice (USPAP) are issued by:

A. The Consumer Financial Protection Bureau

B. Each state's real estate commission

C. The Federal Reserve

D. The Appraisal Foundation's Appraisal Standards Board

8. 5 pts

A listing agent compares recent sales, pending sales and active listings to help a seller choose a list price. This document is:

A. An appraisal, if the agent is licensed

B. A broker price opinion required by FIRREA

C. A comparative market analysis, which is not an appraisal

D. An automated valuation model

9. 5 pts

What is the FIRST step of the appraisal process?

A. Define the problem

B. Collect comparable sales

C. Apply the three approaches

D. Reconcile the value indications

10. 5 pts

In the sales comparison approach, a comparable has a swimming pool and the subject does not. The appraiser should:

A. Add the value of the pool to the subject's value

B. Subtract the value of the pool from the comparable's sale price

C. Add the value of the pool to the comparable's sale price

D. Ignore the pool because the subject lacks one

11. 5 pts

In this example, a comparable sold for $400,000. It has an extra bathroom the subject lacks, worth $8,000, but no garage, while the subject has a garage worth $10,000. What is the comparable's adjusted price?

A. $382,000

B. $398,000

C. $402,000

D. $418,000

12. 5 pts

Which sale would be the LEAST reliable comparable for a single-family appraisal?

A. A similar home in the same subdivision that closed last month

B. A similar home three blocks away that closed four months ago

C. A home of the same model and age that closed two months ago

D. A similar home sold by a mother to her son at a reduced price

13. 5 pts

In this example, a house would cost $450,000 to replace new. It has an effective age of 15 years and an economic life of 50 years, and the land is worth $100,000. What is the value by the cost approach?

A. $415,000

B. $550,000

C. $385,000

D. $315,000

14. 5 pts

A new airport runway brings constant jet noise over a quiet subdivision. The loss in value to the homes is:

A. Physical deterioration, curable

B. Functional obsolescence, incurable

C. Functional obsolescence, curable

D. External obsolescence, incurable

15. 5 pts

The cost to build a structure of equal utility using modern materials and design at today's prices is called:

A. Reproduction cost

B. Replacement cost

C. Historical cost

D. Accrued depreciation

16. 5 pts

The cost approach is generally MOST reliable for appraising:

A. A 70-year-old single-family home in an active market

B. A small apartment building with stable rents

C. A newly built church

D. A vacant residential lot

17. 5 pts

Which item is NOT deducted from effective gross income in computing net operating income?

A. Property taxes

B. Management fees

C. Reserves for replacement

D. Mortgage principal and interest

18. 5 pts

In this example, an apartment building has a net operating income of $90,000, and comparable sales indicate a capitalization rate of 7.5%. What is its value?

A. $675,000

B. $1,200,000

C. $1,125,000

D. $12,000,000

19. 5 pts

In this example, a rental house sold for $270,000 when it rented for $1,800 a month. A similar house rents for $1,900 a month. Using a gross rent multiplier, its indicated value is about:

A. $3,420,000

B. $270,000

C. $285,000

D. $300,000

20. 5 pts

After applying all three approaches, an appraiser arrives at a final opinion of value by:

A. Giving the most weight to the approach most applicable to the property type

B. Averaging the three indications equally

C. Choosing the highest indication to protect the seller

D. Choosing the lowest indication to protect the lender

ANSWER KEY

1. A. DUST — demand backed by purchasing power, utility, scarcity and transferability. D lists the four forces that influence value, a common swap.
2. C. Regression: a better property loses value among lesser ones. Progression is the reverse — the modest house that gains from better neighbors.
3. B. The tests run in order: legally permissible, physically possible, financially feasible, maximally productive. A use the law forbids is eliminated before anything else is considered.
4. D. Contribution: a component is worth what it adds to value, not what it cost. Conformity concerns similarity to neighboring properties.
5. B. Plottage is the increment in value from combining parcels; assemblage is the act of combining them — the classic pair the exam likes to swap.
6. A. Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 created the licensed and certified appraiser requirement. RESPA and TILA govern settlement and credit disclosures.
7. D. USPAP is issued by the Appraisal Standards Board of The Appraisal Foundation, which Congress authorized through FIRREA. States license appraisers but do not write USPAP.
8. C. A CMA is a licensee's marketing analysis. It is not an appraisal and may not be called one; a BPO is usually prepared for a lender, and an AVM is computer-generated.
9. A. The appraiser first defines the problem — client, intended use, type of value, effective date and property rights — then sets the scope, collects data, analyzes highest and best use, applies the approaches, reconciles and reports.
10. B. Adjust the comparable, never the subject. The comp is better, so subtract (comp better, subtract).
11. C. Bathroom: comp better, subtract $8,000. Garage: comp worse, add $10,000. $400,000 − $8,000 + $10,000 = $402,000. B reverses both directions.
12. D. A sale between relatives is not an arm's-length transaction, so its price does not reflect market value. Good comps are recent, nearby, similar and arm's length.
13. A. Depreciation is 15/50 = 30% of $450,000 = $135,000; the building is worth $315,000; adding land gives $415,000. C wrongly depreciates the land, B ignores depreciation, and D forgets the land.

14. D. A cause outside the property is external (economic) obsolescence, and because the owner cannot fix it, it is always incurable.
15. B. Replacement cost means equal utility with modern materials; reproduction cost is an exact replica with the original materials and design.
16. C. The cost approach serves new buildings and special-purpose properties that rarely sell and produce no rent, such as churches and schools. Vacant land is valued by sales comparison, and apartments by income.
17. D. Debt service depends on the buyer's financing, not the property, so it is never an operating expense. Taxes, management and reserves are.
18. B. Value = income ÷ rate: $90,000 ÷ 0.075 = $1,200,000. A multiplies instead of dividing; D misplaces the decimal.
19. C. GRM = $270,000 ÷ $1,800 = 150; value = 150 × $1,900 = $285,000. A applies the multiplier to annual rent — the GRM uses monthly rent.
20. A. Reconciliation is a reasoned weighting, favoring the approach best suited to the property — sales comparison for homes, income for rentals, cost for special-purpose buildings — never a simple average or a choice to favor a party.

PORTFOLIO PIECE: MY PATHWAY FILE — VALUATION

Assemble the valuation section of your Pathway File: the Principles Field Guide from a real neighborhood with its highest-and-best-use analysis (4.1); the "Appraisal or Not?" comparison sheet with the eight-step process and a practice CMA (4.2); the three-comp sales comparison grid in a spreadsheet, tested against the lesson and then applied to real local sales (4.3); the cost-approach worksheet tested against both worked examples and applied to a real older house (4.4); and the income property analysis with its stack, sensitivity table and GRM check (4.5).

Close the section with a one-page reconciliation memo for a single pretend property of your choosing: report the value indicated by each approach you could apply, explain which deserves the most weight and why, and state a final opinion of value with its effective date — clearly labeled as a student exercise and not an appraisal. Date every page.

LOOK FOR	WHAT IT MEANS
Principles field guide	Each principle is matched to a real, specific example, the neighborhood's life-cycle stage is supported with evidence, and the highest-and-best-use analysis applies the four tests in order.
Appraisal-or-not sheet	The four valuation types are correctly distinguished by preparer, purpose and legal use, the process steps are in order, and the practice CMA's price-per-square-foot arithmetic is correct.
Sales comparison grid	The spreadsheet reproduces the lesson's adjusted prices and reconciled value exactly, every adjustment on the real-sales grid goes in the correct direction, and the weighting is justified by gross adjustments.
Cost approach worksheet	The sheet returns $446,040 and $550,000 on the lesson's examples, the real house's depreciation is classified by type and curability, and land is never depreciated.
Income analysis	NOI is built in the correct order with debt service and depreciation excluded, the sheet returns $139,200 and $1,740,000 on the lesson's example, and the sensitivity table shows the inverse cap-rate relationship.

LOOK FOR	WHAT IT MEANS
Reconciliation memo	Written in the student's own words, it weights the approaches by property type rather than averaging, states an effective date, and is honestly labeled as a student exercise rather than an appraisal.

UNIT 5

Financing: Notes, Loans and Lenders

Very few families buy a house with cash. Nearly every sale you will ever help close depends on a loan, and a loan is three things at once: a **promise**, a **pledge** and a piece of **arithmetic**. In this unit you will learn all three. You will meet the **promissory note** and the two instruments that pledge a house for it — the **mortgage** and the **deed of trust** common in the Northwest — and the clauses inside them that decide what happens when a house is sold or a payment is missed. You will compute what a loan really costs: one month of **amortization**, the price of **discount points**, the **loan-to-value ratio** and the full **PITI** payment a lender tests against a family's income.

Then you will sort the loans themselves — conventional, FHA, VA and USDA, adjustable and fixed, balloon and reverse, bank-made and seller-carried — and follow a loan after closing, into the **secondary market** where Fannie Mae, Freddie Mac and Ginnie Mae keep money flowing back to lenders, and, when the promise fails, into **foreclosure**, redemption and the short sale. The stories run from an English judge explaining the "dead pledge" to a Minnesota couple whose case reached the Supreme Court in 1934. Keep your calculator next to your notebook, label every rate and fee "in this example," and remember the rule beneath it all: a licensee explains loans; the family and its lender choose them.

PREREQUISITES

- Can convert between percents and decimals and find a percent of a large number (2% of $236,000; 80% of $295,000) quickly and accurately
- Can explain the difference between legal title and equitable title and between real and personal property, from Units 1 and 2
- Can define a lien and explain lien priority and recording in general terms, from Lesson 2.5
- Has the exam notebook current and a basic calculator of the kind allowed at the testing center

MASTERY CHECKLIST

- ☐ I can tell the note from the security instrument and name every party to a mortgage and a deed of trust, including who holds legal title.
- ☐ I can match the acceleration, alienation, prepayment, defeasance, escalation, subordination and release clauses to the events that trigger them, and tell an assumption from a purchase "subject to."
- ☐ I can split one monthly payment of an amortized loan into interest and principal, and compute points, LTV, down payment and PITI.
- ☐ I can test a payment against example housing and debt-to-income ratios and explain what a credit score measures.
- ☐ I can classify conventional, FHA, VA and USDA loans as uninsured, insured or guaranteed, and apply the Homeowners Protection Act's 80% and 78% rules.
- ☐ I can compute an ARM's rate through several adjustments under initial, periodic and lifetime caps, and explain negative amortization and balloon payments.
- ☐ I can define the reverse mortgage, home equity loan and line, construction, bridge, package, blanket, wraparound and purchase-money loans and the installment land contract.

- ☐ I can explain what Fannie Mae, Freddie Mac and Ginnie Mae do, and compare judicial and nonjudicial foreclosure, the two redemption rights, deficiency judgments, deeds in lieu and short sales.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Consumer Financial Protection Bureau: Buying a House**: Free, official. The federal consumer agency's step-by-step guide to shopping for a mortgage, comparing loan types and understanding the costs. Use it throughout the unit, especially with Lessons 5.2 and 5.3. Ages 15 and up.
- **CFPB: Explore Interest Rates**: Free, official. An interactive tool showing how credit score, down payment, loan type and location change the range of rates lenders are offering today. Use it in Lesson 5.2's project to supply example rates — and date every figure you copy. Ages 15 and up.
- **HUD: FHA Loans and the History of the FHA**: Free, official. HUD's own account of the Federal Housing Administration from 1934 to today, linking to its current loan pages. Read it with Lesson 5.3's story, then use the linked pages to check current FHA terms for your Loan Programs chart. Ages 15 and up.
- **U.S. Department of Veterans Affairs: VA Home Loans**: Free, official. The VA's explanation of eligibility, the certificate of eligibility, funding fees and exemptions, and how the guaranty works. Use it in Lesson 5.3 to fill the VA column of your chart with dated, sourced figures. Ages 15 and up.
- **CFPB: What Is an Adjustable-Rate Mortgage?**: Free, official. A short, plain explanation of index, margin and caps, with links to the CFPB's pages on reverse mortgages and balloon loans. Read it with Lesson 5.4 before building your ARM worksheet. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

5.1	**Notes, Mortgages and Deeds of Trust**	3 sessions of 50 minutes
5.2	**Loan Arithmetic: Interest, Points, LTV and PITI**	3 sessions of 50 minutes

5.3 Conventional, FHA, VA and USDA Loans 3 sessions of 50 minutes

5.4 ARMs, Balloons, Reverse Mortgages and Seller Financing

3 sessions of 50 minutes

5.5 The Secondary Market and Foreclosure 3 sessions of 50 minutes

Unit 5 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Choose the one BEST answer. Figures marked “in this example” are examples: real rates, fees, caps and limits change, and the live ones come from the lender, HUD, the VA or the CFPB. Fourteen correct (70%) matches the common passing line, but aim higher.

1. **5 pts**

   In a mortgage, the borrower is called the:

   A. Mortgagee

   B. Mortgagor

   C. Beneficiary

   D. Trustee

2. **5 pts**

   Under a deed of trust, bare legal title to the property is held by the:

   A. Trustor

   B. Beneficiary

   C. Trustee

   D. County recorder

3. 5 pts

A homeowner deeds her house to her son without paying off the loan, and the lender demands the entire balance. The lender is relying on the:

A. Defeasance clause

B. Subordination clause

C. Escalation clause

D. Alienation clause

4. 5 pts

A buyer purchases a home “subject to” the seller’s existing mortgage and later defaults; the foreclosure sale leaves a deficiency. Who is personally liable for it?

A. The original borrower only

B. The buyer only

C. Both the buyer and the original borrower

D. Neither, because the property was sold

5. 5 pts

In this example, a $180,000 loan at 5% for 30 years has a monthly principal-and-interest payment of $966.28. How much of the first payment reduces the principal?

A. $750.00

B. $216.28

C. $966.28

D. $179,783.72

6. 5 pts

A buyer pays $280,000 for a home and borrows 80% of the price. The lender charges 2.5 discount points. The points cost:

A. $7,000

B. $5,600

C. $4,480

D. $2,800

7. 5 pts

A home sells for $350,000 and appraises for $340,000. The loan is $306,000. What is the loan-to-value ratio?

A. 87.4%

B. 85%

C. 90%

D. 92%

8. 5 pts

A lender’s total debt-to-income (back-end) ratio compares gross monthly income with:

A. Principal and interest only

B. The housing payment plus all other recurring monthly debt payments

C. Net income after taxes

D. Annual property taxes and insurance

9. 5 pts

Which loan may allow an eligible veteran to buy a home with no down payment?

A. FHA-insured loan

B. Conforming conventional loan

C. VA-guaranteed loan

D. Jumbo loan

10. 5 pts

Which statement about the Federal Housing Administration is correct?

A. It insures loans made by approved lenders against loss from default

B. It makes loans directly to first-time buyers

C. It guarantees loans only for veterans

D. It buys conforming conventional loans

11. 5 pts

Under the Homeowners Protection Act, a servicer must automatically terminate PMI on a covered loan when the balance is scheduled to reach:

A. 80% of the home's current market value

B. 80% of original value

C. 78% of the home's current market value

D. 78% of original value

12. 5 pts

In this example, an ARM starts at 4.00% with a margin of 2.50% and caps of 2/2/6. At the first adjustment the index is 4.25%. The new rate is:

A. 6.75%

B. 6.25%

C. 6.00%

D. 10.00%

13. 5 pts

A loan whose balance grows because the monthly payment does not cover all the interest due is experiencing:

A. Negative amortization

B. Acceleration

C. Defeasance

D. Subordination

14. 5 pts

A buyer's loan is secured by the condominium and by the refrigerator, washer and furniture sold with it. This is a:

A. Blanket mortgage

B. Wraparound mortgage

C. Open-end mortgage

D. Package mortgage

15. 5 pts

Under an installment land contract, during the payment period:

A. The vendor holds legal title and the vendee holds equitable title

B. The vendee holds legal title and the vendor holds a mortgage

C. A trustee holds legal title for the vendor

D. Title passes to the vendee when the contract is recorded

16. 5 pts

To obtain an FHA-insured Home Equity Conversion Mortgage, the youngest borrower must be at least:

A. 55

B. 62

C. 65

D. 70

17. 5 pts

Ginnie Mae's role in the secondary market is to:

A. Buy conforming conventional loans from lenders

B. Guarantee timely payment on securities backed by FHA, VA and USDA loans

C. Set the discount rate for member banks

D. Insure lenders against borrower default

18. 5 pts

A borrower in default pays the full balance, interest and costs two days before the scheduled foreclosure sale, and the sale is canceled. The borrower exercised the:

A. Statutory right of redemption

B. Right of rescission

C. Equitable right of redemption

D. Right of first refusal

19. 5 pts

A lender refuses a borrower's offer of a deed in lieu of foreclosure. The MOST likely reason is that:

A. Deeds in lieu are illegal in most states

B. The borrower would remain on title

C. The lender would have to pay the borrower's equity in cash

D. The property has junior liens that the lender would take title subject to

20. 5 pts

Which statement about a short sale is TRUE?

A. The lender must approve accepting less than the amount owed

B. The seller is automatically released from any remaining balance

C. The buyer assumes the seller's remaining debt

D. It is the same as a foreclosure auction

ANSWER KEY

1. B. The borrower gives the mortgage and so is the mortgagor; the lender who receives it is the mortgagee. Choosing A is the exam's favorite trap.
2. C. The trustor (borrower) conveys bare legal title to the trustee, who holds it for the beneficiary (lender) until payoff. The borrower keeps equitable title and possession.
3. D. The alienation (due-on-sale) clause is triggered by a transfer of the property. Defeasance operates at payoff; subordination concerns lien priority.
4. A. A buyer "subject to" the loan never promised to pay it, so only the original maker of the note is personally liable. An assuming buyer would be liable too.
5. B. Interest is $\$180{,}000 \times 0.05 \div 12 = \$750$, so principal is $\$966.28 - \$750 = \$216.28$. A is the interest portion; D is the new balance.
6. B. The loan is $0.80 \times \$280{,}000 = \$224{,}000$, and points are figured on the loan: $2.5\% \times \$224{,}000 = \$5{,}600$. A wrongly uses the price.
7. C. LTV uses the lesser of price or appraisal: $\$306{,}000 \div \$340{,}000 = 90\%$. A divides by the price, the common trap.
8. B. The back-end ratio adds PITI to car, student-loan, credit-card and similar recurring payments. The front-end (housing) ratio uses PITI alone; both use gross, not net, income.
9. C. A VA loan may require no down payment for a borrower with a certificate of eligibility. FHA requires a small down payment; conventional loans usually require one.
10. A. FHA insures; approved private lenders make the loans. VA guarantees veterans' loans; Fannie Mae and Freddie Mac buy conforming loans.
11. D. Automatic termination comes at 78% of original value on the original schedule, if the borrower is current. The borrower may request cancellation earlier, at 80% of original value; current market value does not govern either rule.
12. C. The fully indexed rate is $4.25\% + 2.50\% = 6.75\%$, but the 2-point initial cap limits the rate to $4.00\% + 2\% = 6.00\%$. D is the lifetime ceiling, not this adjustment.
13. A. When the payment falls short of the interest, the unpaid interest is added to principal and the balance rises — negative amortization, possible with payment caps and graduated-payment loans.

14. D. A package mortgage covers real property plus personal property. A blanket mortgage covers several parcels; a wraparound includes an existing loan.
15. A. The seller (vendor) keeps legal title until the price is paid; the buyer (vendee) has possession and equitable title and receives the deed at the end.
16. B. HECM borrowers must be 62 or older and must receive counseling from a HUD-approved counselor; the loan is non-recourse.
17. B. Ginnie Mae buys no loans; it guarantees mortgage-backed securities built from government-backed loans. A describes Fannie Mae and Freddie Mac; C the Federal Reserve; D the FHA.
18. C. Redemption before the sale is equitable redemption. Statutory redemption, where it exists, runs after the sale; rescission belongs to Truth in Lending (Lesson 6.1).
19. D. A lender accepting a deed in lieu takes the property subject to junior liens, which a foreclosure would have wiped out. Deeds in lieu are legal and common when no other liens exist.
20. A. A short sale needs the lender's (and any other lienholder's) approval. The seller is released from the shortfall only by a written waiver or state law, and the buyer takes free of the loan.

PORTFOLIO PIECE: MY PATHWAY FILE — THE FINANCING PAGES

Assemble the financing section of your Pathway File: the two-paper Loan Packet with its labeled note, deed of trust summary, seven clauses and your county's instrument type (5.1); the Loan Calculator Sheet, tested against the lesson's worked examples (5.2); the Loan Programs chart comparing conventional, FHA, VA and USDA loans with every changing figure dated and sourced, plus your neutral memo to a pretend buyer (5.3); the Loan Menu with its twelve balance sketches and the ARM worksheet run through five years of caps (5.4); and the "Follow the Loan" page with its secondary-market and foreclosure flowcharts and your state's deficiency rule (5.5).

Close the section with a one-page cover memo in your own words: explain to a pretend first-time buyer why the note is a promise and the deed of trust a pledge, what PITI and the debt-to-income ratio are really measuring, and why your job is to explain loans clearly rather than to choose one for them. Date every page; Unit 6 will build the closing on top of this financing.

LOOK FOR	WHAT IT MEANS
Loan Packet	Every party to the note and deed of trust is correctly labeled, all seven clauses carry an accurate triggering example, and the assumption, "subject to" and novation box is correct.
Loan Calculator	The sheet reproduces the worked examples exactly ($1,000.00 and $199.10; $236,000 and $4,720; $1,936.68), uses the lesser of price and appraisal for LTV, and labels 28% and 36% as example limits.
Loan Programs chart	Insured and guaranteed are used correctly, the Homeowners Protection Act rules are stated with a correct numerical example, every changing figure is dated and sourced, and the memo describes options without recommending one.
Loan Menu and ARM worksheet	All twelve loan types are defined accurately with correct balance sketches, and each ARM adjustment applies the initial or periodic cap and then the lifetime cap correctly.
Follow the Loan	The secondary-market flowchart distinguishes buying from guaranteeing, the foreclosure flowchart places equitable and statutory redemption on the correct sides of the sale, and the state deficiency rule is cited to an official source with a date.

LOOK FOR	WHAT IT MEANS
Cover memo	Written in the student's own voice, it explains note versus pledge, PITI and DTI accurately and states the licensee's role — to explain, not to choose — in plain language.

5.1 Notes, Mortgages and Deeds of Trust

OBJECTIVES

- Distinguish the promissory note (the evidence of the debt) from the security instrument (the pledge of the property), and name the parties to each.
- Compare a two-party mortgage with a three-party deed of trust, including who holds title, how the loan is released and how a default is handled.
- Explain lien theory, title theory and intermediate theory and what each means for the borrower's title.
- Identify the acceleration, alienation, prepayment, defeasance, escalation, subordination and release clauses from a description of what each does.
- Decide whether a buyer who takes over a seller's loan is personally liable by telling an assumption from a purchase "subject to" the loan.

> **Warm-up.** Write one sentence promising to repay a friend $50 by Friday. Now ask: if you never pay, what can your friend actually take? Nothing — unless you also hand over your bicycle as a pledge. Write a second sentence pledging the bike. You have just written a note and a security instrument, the two papers behind every home loan in America.

WATCH

Promissory Note & Mortgage | Real Estate Exam

The Real Estate Classroom · 15:12

https://www.youtube.com/watch?v=5BTtVEENhvg

> **WHEN TO WATCH**
> Watch after the big idea; draw two columns headed "Note" and "Mortgage" and sort every term he names into the right column as he goes.

BACKUP VIDEO

Types of Clauses | Real Estate Exam Prep

PrepAgent · 4:44

https://www.youtube.com/watch?v=6_IIGioM8-g

Watch right before the practice set; pause after each clause and say aloud the event that triggers it before the narrator does.

promissory note

The borrower's written, signed promise to repay a stated sum on stated terms; it is the evidence of the debt and creates personal liability.

maker and payee

The maker is the borrower who signs and promises to pay the note; the payee is the lender to whom payment is promised.

negotiable instrument

A written, unconditional promise to pay a sum certain that can be transferred to another holder, which is why notes can be sold on the secondary market.

hypothecation

Pledging property as security for a debt without giving up possession of it, as every homeowner with a mortgage does.

mortgage (mortgagor and mortgagee)

A two-party security instrument in which the borrower (mortgagor) gives a lien on real property to the lender (mortgagee).

deed of trust (trustor, trustee, beneficiary)

A three-party security instrument in which the borrower (trustor) conveys bare legal title to a neutral trustee, who holds it for the lender (beneficiary) until the debt is paid.

deed of reconveyance

The instrument by which the trustee returns title to the trustor once the loan secured by a deed of trust is paid in full.

lien theory and title theory

In lien-theory states the borrower keeps title and the lender holds only a lien; in title-theory states the lender (or trustee) holds legal title until the debt is paid; intermediate states pass title to the lender on default.

acceleration clause

A clause allowing the lender, on the borrower's default, to declare the entire remaining balance immediately due and payable.

alienation (due-on-sale) clause

A clause allowing the lender to call the whole loan due if the borrower sells or transfers the property, preventing an assumption without consent.

defeasance clause

A clause that defeats the lender's interest when the debt is paid, requiring the lender to release the lien by a satisfaction or reconveyance.

assumption vs. "subject to"

A buyer who assumes a loan becomes personally liable for it; a buyer who takes title "subject to" the loan is not personally liable, though the property can still be lost to foreclosure.

CORE IDEAS

The story. Around 1481, the year he died, the English judge Sir Thomas Littleton finished a small book in law French called the *Tenures*, and in it he explained a strange word. A man who borrowed money could convey his land to the lender "upon condition" that if he repaid the sum on a fixed day, he could re-enter and take the land back. Why was this called a **mortgage** — literally a "dead pledge"? Because, Littleton wrote, if the borrower failed to pay on the day, the land was taken from him forever and so was dead to him; and if he paid, the pledge was dead to the lender. Medieval law meant it. A borrower who arrived with the money one day late, after the "law day," lost the land outright, however much it was worth and however little he owed. In 1628 Sir Edward Coke published his famous commentary on Littleton, and English lawyers memorized both for two centuries. Every American home loan still carries that old word — and the old danger it named.

How they figured it out. The cure came from the Court of Chancery, the king's court of conscience. Through the 1600s its judges decided that a mortgage was really security for a debt, not a sale, and that a borrower who paid late should still be allowed to redeem his land. They called this the **equity of redemption** and coined the maxim "once a mortgage, always a mortgage." To end the borrower's right, the lender had to go to court and ask that it be cut off — **foreclosed.** Two ideas grew from those cases and govern every loan you will see on the exam. First, the *debt* and the *security* are different things, written in different documents. Second, the law protects a borrower's chance to cure a default, and the lender may take the property only through a process the law prescribes. American states later built two such processes — the court-supervised judicial foreclosure and the power-of-sale foreclosure used with deeds of trust — which Lesson 5.5 teaches in detail.

The big idea. Every secured real estate loan rests on two papers. The **promissory note** is the promise: the borrower (the **maker**) promises to pay the lender (the **payee**) a stated principal, at a stated interest rate, on stated terms. The note is the

evidence of the debt and makes the borrower personally liable. It is a **negotiable instrument**, so the lender can sell it — which is how the secondary market of Lesson 5.5 works. The **security instrument** is the pledge: it ties the debt to the land, so that if the promise is broken, the property can be sold to pay it. Because the borrower keeps living in the house while it secures the loan, the arrangement is called **hypothecation**. Keep the roles straight: the borrower *gives* the mortgage, so the borrower is the **mortgagor**; the lender *receives* it and is the **mortgagee**. A note can exist without a mortgage (an unsecured loan), but a mortgage cannot stand without a debt to secure.

The two security instruments differ in their parties. A **mortgage** has two: mortgagor and mortgagee. A **deed of trust** has three: the borrower (**trustor**) conveys bare, or "naked," legal title to a neutral **trustee**, who holds it for the lender (**beneficiary**); the borrower keeps equitable title and full use of the home. When the loan is paid, the beneficiary tells the trustee to issue a **deed of reconveyance** returning title to the borrower. If the borrower defaults, the deed of trust usually contains a **power of sale** letting the trustee sell the property at a trustee's sale without a lawsuit. States also differ in theory. In **lien-theory** states the borrower holds title and the lender holds only a lien; in **title-theory** states the lender or trustee holds legal title until payoff; **intermediate** states treat the loan as a lien until default, when title can pass to the lender. Deeds of trust are widely used in the West: Washington's Deed of Trust Act (RCW 61.24) and Oregon's trust-deed statutes (ORS 86.705 to 86.815) both provide for nonjudicial trustee's sales. Your state's pre-licensing course will tell you which instrument and theory your state uses.

Inside the note and security instrument live the **clauses** the exam loves. The **acceleration clause** lets the lender, on default, declare the whole remaining balance due at once — without it, the lender could sue only for each missed payment. The **alienation clause**, or due-on-sale clause, lets the lender call the loan due if the borrower sells or transfers the property; it is the reason most modern conventional loans cannot be assumed without the lender's consent. The **prepayment clause** states whether the borrower may pay early; a **prepayment penalty** charges for doing so, and a "lock-in" clause forbids it. The **defeasance clause** defeats the lender's interest when the debt is paid: the lender must then record a **satisfaction** (release) of mortgage, or the trustee a reconveyance. An **escalation clause** lets the lender raise the rate on stated events. A **subordination clause** lets a later loan take priority over

this one, as when a landowner's loan agrees to stand behind a construction loan. A **release clause** in a blanket loan lets individual lots be freed from the lien as they are sold — a **partial release**.

What happens when a house with a loan is sold? Usually the seller's loan is paid off at closing. But sometimes a buyer takes over the existing loan, and the exam tests two ways. In an **assumption**, the buyer agrees to become personally liable on the note; the lender usually must approve, and the seller stays liable too unless the lender releases the seller by a **novation**, which substitutes the new borrower for the old. In a purchase **"subject to"** the existing loan, the buyer pays the loan but never promises to: if payments stop, the lender can foreclose and take the house, but cannot pursue the buyer personally for any deficiency — the original seller remains the one personally liable. An alienation clause can block either arrangement. Finally, remember what is recorded. The security instrument — mortgage or deed of trust — is recorded in the county where the land lies, giving constructive notice and establishing lien priority; the note itself usually is not. At payoff, the satisfaction or reconveyance is recorded to clear the title, a fact a title examiner in Lesson 6.4 will look for.

On the exam today. Financing is about a tenth of the national exam, and this lesson supplies its vocabulary questions. Expect "Who is the mortgagor?" — the *borrower*, because the borrower gives the mortgage; the exam's favorite trap is choosing the lender. Expect "In a deed of trust, who holds legal title?" — the *trustee*, not the lender (the beneficiary) and not the borrower (the trustor, who keeps equitable title). Expect clause matching: default triggers acceleration; sale triggers alienation; payoff triggers defeasance; lot-by-lot freedom is a release clause; giving up priority is subordination. Expect "What is the evidence of the debt?" — the note; "What makes the property security?" — the mortgage or deed of trust. Expect the assumption trap: a buyer who takes "subject to" the loan is *not* personally liable; an assuming buyer is, and the seller stays liable unless a novation releases him. And remember that a deed of trust is released by a *reconveyance* from the trustee, a mortgage by a *satisfaction* from the lender.

PICTURE STUDY



A Notary in His Office, Job Adriaensz. Berckheyde, 1672 · Oil on canvas · Private collection

Image: Wikimedia Commons, public domain

Job Berckheyde (1630–1693) of Haarlem painted the busy public spaces of the Dutch Republic — its churches, exchanges and city squares — and, here, the quiet office where its contracts were made. In the 1600s a Dutch notary drew up and kept the instruments that secured loans on houses and land, and a borrower's promise became a written, witnessed document that could be relied on, sold and enforced. This picture opens the lesson on the note and the security instrument because it shows the moment a promise becomes paper: a client hands over a document, a clerk writes, and the shelves behind them hold the records of a whole town's obligations.

Look closely

- Follow the folded paper passing from the visitor's hand to the notary's. A promise to repay becomes enforceable only when it is written and signed — the note.
- Find the clerk writing at the desk. Instruments were copied carefully, because a mistake in a name or a sum could defeat the whole document.
- Look at the shelves of papers and books. Every one stands for an obligation someone made and someone else relied upon, like the recorded mortgages in a county office today.

- Notice the notary's relaxed, expensive robe beside the visitor's plain coat. Who usually has more power in a loan — and why does the law add protections for the weaker party?

Talk about it

1. Which document in this office would you guess is the "note," and which the "security"? What would each need to say?
2. Why did Dutch and English law both insist that obligations about land be written and kept on record rather than left to memory?
3. Proverbs warns against striking hands as surety for debts you cannot pay. What does it look like, practically, to make only the promises you can keep?

PROJECT

The Two-Paper Loan Packet

You will build a one-page "loan packet" for a pretend family that shows, side by side, what the promissory note says and what the security instrument does — with every party labeled and every key clause explained in your own words. Then you will check your own county's recorder index to see which security instrument is actually recorded where you live. The finished packet is the first financing page in your Pathway File.

You will need

- Two sheets of paper or a two-column spreadsheet
- This lesson's key terms and clause list
- Your county recorder's or auditor's online document-search page (searching by document type only)
- Colored pencils for labeling parties

Steps

1. Invent the loan: a pretend family, a pretend lender, a pretend house, a principal between $200,000 and $400,000, an example rate and a 30-year term.
2. On the left half, write a short plain-English promissory note: maker, payee, principal, rate, monthly payment date, term and a sentence on late payment. Label the maker and payee in color.
3. On the right half, write a one-paragraph summary of a deed of trust securing that note, labeling the trustor, trustee and beneficiary, and stating who holds legal and equitable title.
4. Beneath it, list seven clauses — acceleration, alienation, prepayment, defeasance, escalation, subordination and release — each with a one-sentence example of the event that would trigger it.
5. Add a box titled "If the house is sold": explain in three sentences the difference between an assumption, a purchase "subject to" and a novation.

6. Search your county recorder's index by document type (not by anyone's name) and note whether recent instruments are titled "deed of trust," "mortgage" or both, and what document is recorded when a loan is paid off. Do not copy any person's name or address.
7. Title the page "Loan Packet — Note and Security," date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for mortgagor, mortgagee, trustor, trustee, beneficiary, maker and payee — front: the title; back: borrower or lender (or neutral), and what that party gives or receives.
2. Draw the triangle of a deed of trust: trustor at the left corner, beneficiary at the right, trustee at the top holding a small scroll labeled "bare legal title," with arrows for the loan, the payments and the reconveyance.
3. Write a trap list titled "Which clause?" pairing each event — default, sale, payoff, new construction loan, selling one lot — with its clause.

> **From history.** Mortgages are older than Littleton. Around 1188 the treatise called *Glanvill*, written in the court of Henry II, already distinguished two kinds of land pledge. In a "living pledge" (*vivum vadium*) the lender took the land's rents and applied them to the debt until it was paid, so the pledge worked itself free. In a "dead pledge" (*mortuum vadium*) the rents did not reduce the debt at all. The difference — does each payment shrink what you owe? — is exactly the difference between an amortized loan and an interest-only one, as Lesson 5.2 will show.

Example 1. The Nakamura family borrows $320,000 from Evergreen Savings (a pretend lender) to buy a house. They sign a note and a deed of trust naming Cascade Escrow Services (a pretend company) as trustee. Name every party by its exam title, and say who holds legal title, who holds equitable title and what happens at payoff.

Show solution

1. The note: the Nakamuras are the **makers** (they promise to pay); Evergreen is the **payee**.
2. The deed of trust: the Nakamuras are the **trustors**, Cascade Escrow Services is the **trustee**, and Evergreen is the **beneficiary**.
3. Title: the trustee holds bare legal title for the lender; the Nakamuras keep equitable title, possession and every ordinary use of the home.
4. Payoff: the defeasance clause operates — Evergreen tells the trustee to issue a **deed of reconveyance**, which is recorded to clear the title.

Answer: Makers/trustors: the Nakamuras. Payee/beneficiary: Evergreen. Trustee: Cascade Escrow Services, holding bare legal title. At payoff the trustee reconveys title to the family.

Example 2. Mr. Ortiz has a conventional loan containing an alienation clause and an acceleration clause. He deeds his house to his nephew, who agrees to keep making the payments, without telling the lender. The lender learns of the transfer. What may the lender do, and which clause does what?

Show solution

1. Identify the triggering event: a transfer of the property, not a missed payment. That is the territory of the **alienation (due-on-sale) clause**.
2. The alienation clause gives the lender the right to call the loan due because of the transfer.
3. The **acceleration clause** is the mechanism that makes the entire remaining balance due at once.
4. If the balance is not paid, the lender may foreclose on the property, whoever now owns it.

Answer: The lender may declare the whole balance due. The alienation clause supplies the reason (the transfer), and the acceleration clause supplies the remedy (everything due now).

Example 3. Exam style. Ruth sells her house to Daniel, who takes title "subject to" Ruth's existing mortgage. Two years later Daniel stops paying, and a foreclosure sale leaves a deficiency of $18,000. Who may the lender pursue for the deficiency?

A. Daniel only

B. Ruth only

C. Both Ruth and Daniel

D. Neither, because the property was sold

Show solution

1. Ask who signed the note. Ruth did; Daniel never promised the lender anything.
2. A buyer "subject to" a loan is not personally liable; the lender's only claim against him is the property itself.
3. Ruth remains personally liable on her note because no novation released her.
4. Had Daniel *assumed* the loan, both he and Ruth would be liable (unless a novation released Ruth).

Answer: B. Only Ruth, the original maker of the note, is personally liable; Daniel lost the house but owes nothing personally because he took "subject to" rather than assuming.

PRACTICE

1. Easy What is the difference between a promissory note and a mortgage?

   Show answer

   The note is the borrower's promise to repay — the evidence of the debt, creating personal liability. The mortgage is the security instrument that pledges the property for that debt so it can be sold if the promise is broken.

2. Easy In a mortgage, which party is the mortgagor?

   Show answer

   The borrower. The borrower gives the mortgage to the lender, so the borrower is the mortgagor and the lender is the mortgagee — remember that "-or" gives and "-ee" receives.

3. Easy Name the three parties to a deed of trust and say which one holds bare legal title.

Show answer

The trustor (borrower), the trustee (neutral third party) and the beneficiary (lender). The trustee holds bare legal title for the beneficiary until the loan is paid.

4. Medium A borrower misses four payments. Which clause lets the lender demand the entire remaining balance instead of only the four missed payments?

Show answer

The acceleration clause. Without it the lender could sue only for installments already due; with it, default makes the whole balance immediately due and payable.

5. Medium A developer's blanket loan covers 40 lots. As each lot sells, the buyer needs a clear title to that lot. What clause makes this possible?

Show answer

A release (partial release) clause. It lets the lender release individual parcels from the blanket lien, usually upon payment of a stated amount per lot.

6. Medium A landowner's loan states that it will take second place behind a construction loan the owner will obtain later. What is this clause, and why would the first lender agree?

Show answer

A subordination clause — the first lender voluntarily gives up priority. It agrees because the construction loan will build improvements that raise the value of the very land securing its own loan.

7. Medium Explain the difference between a lien-theory state and a title-theory state.

Show answer

In a lien-theory state the borrower holds title and the lender holds only a lien on the property. In a title-theory state the lender (or a trustee) holds legal title until the debt is paid, with the borrower holding equitable title and possession; intermediate states treat it as a lien until default.

8. Hard A loan is paid in full, but the lender never records a satisfaction. Years later the owner tries to sell. What problem appears, and which clause gave the owner the right to fix it?

Show answer

The recorded mortgage still appears as an open lien, clouding the title and holding up the sale. The defeasance clause obligated the lender to release its interest on payment, so the owner can demand a recordable satisfaction (or reconveyance for a deed of trust).

9. Hard A buyer assumes the seller's FHA loan with the lender's approval, but no novation is signed. The buyer later defaults. Who is personally liable?

Show answer

Both. By assuming, the buyer became personally liable on the note; the seller stays liable too, because only a novation would have released the seller and substituted the buyer.

10. Hard Why does a lender want the alienation clause, especially when rates have risen since the loan was made?

Show answer

If rates rise, an old low-rate loan is a bargain a buyer would love to take over, while the lender would rather be repaid and relend at today's higher rate. The alienation clause lets the lender call the loan due on sale, and it also lets the lender approve the creditworthiness of anyone who takes over its security.

11. Challenge Trace a deed of trust from closing to payoff, naming each document and who signs or issues it: the loan, the recording, thirty years of payments, and the final payment.

Show answer

At closing the borrower signs the note (maker) and the deed of trust (trustor), conveying bare legal title to the trustee for the lender. The deed of trust is recorded in the county, giving constructive notice and setting priority. The borrower keeps equitable title and pays the beneficiary for thirty years. At payoff the defeasance clause operates: the beneficiary requests reconveyance, the trustee signs a deed of reconveyance, and it is recorded to clear the title.

12. **Challenge** Littleton explained that a mortgage was a “dead pledge.” Using the equity of redemption, explain how Chancery changed the meaning of that phrase, and connect it to one protection borrowers still have.

Show answer

Under the old rule the land became dead to a borrower who missed the law day, even by a day. Chancery treated the mortgage as mere security and let a late borrower redeem by paying, so the land could be cut off only by foreclosure. Borrowers still hold that equitable right of redemption — the right to pay off the debt and save the property up until the foreclosure sale.

COMMON MISTAKES

- Calling the lender the mortgagor — the borrower gives the mortgage and is the mortgagor; the lender is the mortgagee.
- Saying the lender holds title under a deed of trust — the trustee holds bare legal title for the lender (the beneficiary), and the borrower keeps equitable title.
- Confusing acceleration with alienation — acceleration makes the balance due (the remedy); alienation is the due-on-sale trigger.
- Thinking a buyer “subject to” the loan is personally liable — only an assuming buyer is; the original borrower stays liable either way unless a novation releases him.
- Believing the note is recorded — the mortgage or deed of trust is recorded to give notice and priority; the note is the private evidence of the debt.
- Mixing up the payoff documents — a mortgage is released by a satisfaction from the lender; a deed of trust by a deed of reconveyance from the trustee.

> **Make it a game · Who Gives, Who Gets?.** Write fourteen cards: mortgagor, mortgagee, trustor, trustee, beneficiary, maker, payee, acceleration, alienation, defeasance, subordination, release, assumption and “subject to.” A parent reads a card; the first player to slap the table must call out “borrower,” “lender,” “neutral” or, for a clause, the event that triggers it (default, sale, payoff, construction loan, lot sale, takeover with liability, takeover without). Right answers win the card; wrong answers return it to the deck. Play two rounds, the second against a 60-second timer. The winner keeps the title “Chancellor” until the next game.

> **Scripture.** “Be not thou one of them that strike hands, or of them that are sureties for debts. If thou hast nothing to pay, why should he take away thy bed from under thee?” (Proverbs 22:26-27, KJV)
>
> Solomon describes the security instrument exactly: a pledge that can take the bed — or the house — from under the one who cannot pay. The proverb does not forbid every loan, but it warns that a signature on a note and a mortgage is a serious promise with a real pledge behind it. Understanding what you sign is the first act of wisdom with debt.

5.2 Loan Arithmetic: Interest, Points, LTV and PITI

OBJECTIVES

- Compute simple interest for a year and for a month, and split one monthly payment of a fully amortized loan into interest and principal.
- Explain why the interest portion of a level payment falls and the principal portion rises over the life of the loan.
- Compute the cost of discount points and origination fees, and distinguish points that buy down the rate from fees that pay the lender for making the loan.
- Calculate the loan-to-value ratio, the down payment and the maximum loan from a price, an appraisal and an LTV limit.
- Assemble a monthly PITI payment and test it against example housing and total debt-to-income ratios.

> **Warm-up.** Without a calculator, find 6% of $200,000, then divide your answer by 12. You have just computed the first month's interest on a typical home loan. Now guess: if the monthly payment is about $1,200, how much of that first payment actually reduces what the family owes? Write your guess down and check it in the first worked example.

WATCH

Introduction to Mortgage Loans | Housing | Finance & Capital Markets | Khan Academy

Khan Academy · 18:06

https://www.youtube.com/watch?v=y-1Gh4ewklY

> **WHEN TO WATCH**
> Watch after the big idea; when the spreadsheet appears, copy the first three rows of the amortization table into your notebook and check his interest figure for month one yourself.

BACKUP VIDEO

Real Estate Math Video #2 - Calculating Discount Points | Real Estate Exam Prep

The Real Estate Classroom · 7:32

https://www.youtube.com/watch?v=tMknWBxMCB8

Watch during Session 3 before practice problems 2, 9 and 10; work each of his examples on paper before he shows the answer.

KEY TERMS

principal

The amount borrowed, or the unpaid balance of a loan on which interest is charged.

simple interest

Interest computed only on the principal: Interest = Principal × Rate × Time.

amortization

Repaying a loan by regular payments that cover each period's interest and reduce the principal, so that the balance reaches zero at the end of the term.

fully amortized loan

A loan whose level payments are large enough to pay off the entire principal and interest by the end of the term, with no balloon.

discount points

Prepaid interest paid at closing to lower the note rate; one point equals 1% of the loan amount, not of the price.

origination fee

A charge by the lender for processing and making the loan, often expressed as a percentage of the loan amount.

loan-to-value ratio (LTV)

The loan amount divided by the property's value, which lenders take as the lesser of the sales price or the appraised value.

PITI

The full monthly housing payment: principal, interest, property taxes and homeowners insurance, with mortgage insurance and association dues added when they apply.

escrow (impound) account

An account the lender or servicer keeps to collect monthly shares of the borrower's taxes and insurance and pay those bills when due.

housing expense ratio

The monthly housing payment (PITI) divided by gross monthly income; also called the front-end ratio.

debt-to-income ratio (DTI)

The monthly housing payment plus all other recurring monthly debt payments, divided by gross monthly income; also called the back-end ratio.

credit score

A number computed from a credit report that predicts how likely a borrower is to repay, used by lenders to approve and price loans.

CORE IDEAS

The story. On January 3, 1831, a group of working men in Frankford, a mill village just outside Philadelphia, met and founded the Oxford Provident Building Association — commonly called the first savings and loan in the United States. The idea came from British building societies: each member paid a small sum every month into a common fund, and when enough had gathered, the fund lent it to one member to buy or build a house. That April the association made one of its first loans: $375 to Comly Rich, described in the records as a lamplighter (some accounts say a comb maker), toward a $500 house on Orchard Street. His little frame house still stands. What made the plan work was not a rich patron but arithmetic — regular,

modest, predictable payments, applied month after month, until a working man owned his home outright. That arithmetic is the subject of this lesson.

How they figured it out. For a century, though, most American home loans did not work like the Frankford plan. Banks commonly lent half a house's value for five years or so, the borrower paid interest only, and the whole principal fell due at the end in one **balloon** — which the borrower usually hoped to refinance. When credit froze in the early 1930s, hundreds of thousands of families could not refinance, and lost their homes. In 1933 Congress created the Home Owners' Loan Corporation, which refinanced roughly a million troubled mortgages into long, **fully amortized** loans: one level payment, every month, covering that month's interest and a slice of principal, so that the last payment retires the debt. The Federal Housing Administration of 1934 spread the pattern nationwide (Lesson 5.3). The building-and-loan arithmetic of Frankford had become the American mortgage.

The big idea. Interest is rent paid for the use of money. **Simple interest** is $I = P \times R \times T$: principal times annual rate times time in years. Mortgage interest is charged monthly on the unpaid balance, so one month's interest is the balance times the annual rate divided by twelve. In a **fully amortized** loan the payment is level — the same every month — but its contents change. In month one the balance is largest, so interest takes most of the payment and only a little reduces principal. Each month the balance shrinks a bit, so the interest portion shrinks and the principal portion grows by the same amount. In this example, a $200,000 loan at 6% for 30 years has a payment of about $1,199.10; month one's interest is $1,000, so only $199.10 goes to principal. Over thirty years the family pays about $431,676 in all — roughly $231,676 of it interest. Amortization tables and calculators produce the payment; the exam expects you to compute one month's split by hand.

Lenders charge for loans in two ways besides the rate. **Discount points** are prepaid interest paid at closing to "buy down" the note rate; one point is 1% of the *loan amount* — never of the price. Two points on a $236,000 loan cost $4,720. A traditional exam rule of thumb says each point raises the lender's effective yield by about one-eighth of a percentage point; treat it as an approximation for exam problems, not a pricing rule. An **origination fee**, also stated as a percentage of the loan, pays the lender for processing and making the loan rather than lowering the rate. Points may be paid by the buyer or, if the contract says so, by the seller. Whether a borrower should pay points is a break-even question: divide the cost of the points by the

monthly savings to find how many months it takes to earn them back — a family that will move sooner should not pay them.

The **loan-to-value ratio** measures how much of the property the lender is financing: loan divided by value, where value means the *lesser* of the sales price or the appraised value. If a buyer agrees to pay $300,000 but the appraisal comes in at $295,000, an 80% LTV loan is $0.80 \times \$295{,}000 = \$236{,}000$, and the buyer must bring the rest — $64,000 — as down payment. The higher the LTV, the greater the lender's risk, so loans above 80% LTV commonly require mortgage insurance (Lesson 5.3). The monthly payment a lender cares about is **PITI**: principal and interest, plus one-twelfth of the annual property taxes and one-twelfth of the annual homeowners insurance, which the servicer usually collects into an **escrow (impound) account** and pays when the bills come due. Mortgage insurance and owners' association dues are added when they apply.

Lenders then ask whether the family can carry the payment. Two **qualifying ratios** do the work. The **housing expense ratio** (front-end) is PITI divided by gross monthly income. The **debt-to-income ratio** (back-end) is PITI plus every other recurring monthly debt — car payments, student loans, minimum credit-card payments, child support — divided by gross monthly income. The traditional textbook example limits are 28% and 36%, and the exam often uses them; real limits vary by loan program and lender and are set by underwriting rules that change, so always treat 28/36 as an example. Lenders also pull a **credit report** and score. The most widely used models score roughly 300 to 850 and weigh payment history most heavily, then amounts owed, length of credit history, new credit and the mix of credit types. Federal law (the Fair Credit Reporting Act) lets every consumer see the report and dispute errors — a habit worth starting before you ever apply.

On the exam today. Real estate math is about 7% of the national exam, and loan arithmetic is a reliable share of it. Expect a one-month amortization question: compute the interest (balance × rate ÷ 12), subtract it from the payment to find principal, and subtract that from the balance — the trap answer forgets to divide by twelve. Expect "a point is 1% of the *loan*" — the trap computes it on the sales price. Expect LTV on the lesser of price or appraisal — the trap uses the price when the appraisal is lower. Expect PITI assembly with annual taxes and insurance that must be divided by twelve, and a qualifying-ratio question where the answer is a maximum payment (income × ratio) or a minimum income (payment ÷ ratio).

Expect the concept question: in a fully amortized loan, the interest portion of each payment *decreases* while the principal portion *increases*, though the payment stays level.

PICTURE STUDY



Jakob Fugger in His Counting House with His Chief Accountant Matthäus Schwarz, Augsburg illuminator, for Matthäus Schwarz, 1517 · Watercolor and gouache on parchment, from Schwarz's illustrated book of his own life and dress · Herzog Anton Ulrich-Museum, Braunschweig

Image: Wikimedia Commons, public domain

Jakob Fugger of Augsburg (1459–1525) was the greatest banker of his age, lending to emperors and popes and keeping branches across Europe. In 1517 his chief accountant, Matthäus Schwarz, had himself painted at work beside his master for the book of pictures Schwarz kept of his own life. Schwarz later wrote a treatise on double-entry bookkeeping, and the drawers behind the two men are labeled with the cities where the firm kept accounts. This picture opens the lesson on loan arithmetic because it shows what every lender, large or small, actually runs on: careful records of principal, interest and payments, kept honestly page after page.

Look closely

- Read the labels on the drawers — Rome, Venice, Nuremberg, Innsbruck, Lisbon and more. Each drawer held the accounts of one branch; a modern amortization schedule is a drawer for one loan.
- Watch the clerk's pen on the open ledger. Every entry separates what was paid into interest and principal, just as you will do for month one.
- Notice the master pointing and the clerk writing. Who checks the arithmetic, and who is responsible if it is wrong?

- Look at the scattered papers on the floor. Even a great house's records needed constant attention — a lesson for anyone who will someday keep a family's accounts.

Talk about it

1. If Schwarz recorded a loan payment, what two numbers would he need to write down for it to be useful later?
2. Why might a banker as powerful as Fugger still insist on an accountant who could prove every figure?
3. Jesus says a builder first "counteth the cost." What would counting the cost of a house look like for your family, in numbers and in character?

PROJECT

The Loan Calculator Sheet

You will build a one-page loan calculator — on paper or in a spreadsheet — that takes a price, an appraisal, an LTV limit, a rate and a term and produces the loan amount, down payment, points, the first three months of amortization, PITI and both qualifying ratios. Every later financing lesson will reuse it, and it becomes the working tool of your Pathway File's financing section.

You will need

- A spreadsheet program or graph paper and a basic calculator
- The six formulas in this lesson
- A free online mortgage payment calculator (any one) to supply the monthly principal-and-interest figure
- This lesson's worked examples for testing

Steps

1. Make input cells: price, appraised value, LTV limit, rate, term in years, points, annual taxes, annual insurance, gross monthly income and other monthly debts.
2. Compute the loan as LTV × the lesser of price and appraisal, then the down payment and the cost of the points.
3. Enter the monthly principal-and-interest payment (from a calculator, or with the spreadsheet's payment function).
4. Build a three-row amortization table: beginning balance, interest (balance × rate ÷ 12), principal (payment − interest) and ending balance.
5. Compute PITI and both qualifying ratios, and flag each ratio "passes" or "fails" against 28% and 36%, labeled "example limits."
6. Test the sheet against all three worked examples; it must reproduce $1,000.00, $199.10, $236,000, $4,720 and $1,936.68 exactly.
7. Print or copy the finished sheet, title it "Loan Calculator," date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for each formula — front: the name (LTV, PITI, points, monthly interest, DTI); back: the formula and a one-line example with numbers.
2. Draw a stacked bar chart of three payments — month 1, month 180 and month 360 — showing the interest and principal shares changing while the bar's height stays the same.
3. Write a trap list titled "Divide by what?": points on the loan, LTV on the lesser value, taxes and insurance ÷ 12, monthly interest ÷ 12.

KEY FORMULAS

$$\text{Interest} = \text{Principal} \times \text{Rate} \times \text{Time}$$

$$\text{Monthly interest} = \frac{\text{Balance} \times \text{Annual rate}}{12}, \quad \text{Principal paid} = \text{Payment} - \text{Monthly interest}$$

$$\text{Cost of points} = \text{Loan amount} \times (\text{Number of points} \times 1\%)$$

$$\text{LTV} = \frac{\text{Loan amount}}{\text{Lesser of price or appraised value}}$$

$$\text{PITI} = \text{P\&I} + \frac{\text{Annual taxes}}{12} + \frac{\text{Annual insurance}}{12}$$

$$\text{Housing ratio} = \frac{\text{PITI}}{\text{Gross monthly income}}, \quad \text{DTI} = \frac{\text{PITI} + \text{Other monthly debts}}{\text{Gross monthly income}}$$

From history. Building-and-loan associations spread quickly after Frankford. By the 1890s there were several thousand across the country, many organized by neighbors, churches and mutual-aid societies. Early "terminating" associations dissolved once every member had borrowed and repaid; later "serial" and "permanent" plans let new members join at any time. Their monthly dues-and-loan arithmetic trained a generation of ordinary savers in compound interest — decades before the Home Owners' Loan Corporation made amortization the national standard.

Example 1. In this example, a family borrows $200,000 at 6% for 30 years, fully amortized, with a monthly principal-and-interest payment of $1,199.10. How much of the first payment is interest, how much is principal, and what is the balance after the first payment? What is the second month's interest?

Show solution

1. Month-one interest: $\$200{,}000 \times 0.06 \div 12 = \$1{,}000.00$.
2. Principal paid: $\$1{,}199.10 - \$1{,}000.00 = \$199.10$.
3. New balance: $\$200{,}000 - \$199.10 = \$199{,}800.90$.
4. Month-two interest: $\$199{,}800.90 \times 0.06 \div 12 \approx \$999.00$ — about a dollar less, so about a dollar more goes to principal.

Answer: Interest $1,000.00, principal $199.10, new balance $199,800.90; month two's interest is about $999.00.

Example 2. A buyer contracts to pay $300,000 for a house that appraises at $295,000. In this example the lender will lend 80% LTV and charges 2 discount points. Find the loan amount, the down payment and the cost of the points.

Show solution

1. Value for LTV purposes is the lesser of price and appraisal: $295,000.
2. Maximum loan: $0.80 \times \$295{,}000 = \$236{,}000$.
3. Down payment: $\$300{,}000 - \$236{,}000 = \$64{,}000$ — the buyer must cover the appraisal shortfall too.
4. Points: $2\% \times \$236{,}000 = \$4{,}720$, computed on the loan, not the price.

Answer: Loan $236,000; down payment $64,000; points $4,720.

Example 3. The same $236,000 loan at 6.5% for 30 years has a principal-and-interest payment of $1,491.68. Annual taxes are $3,900 and annual insurance is $1,440. The family earns $7,000 a month gross and has $600 in other monthly debts. Compute PITI and test it against example ratios of 28% and 36%.

Show solution

1. Monthly taxes and insurance: $\$3{,}900 \div 12 = \$325$ and $\$1{,}440 \div 12 = \$120$.
2. PITI: $\$1{,}491.68 + \$325 + \$120 = \$1{,}936.68$.
3. Housing ratio: $\$1{,}936.68 \div \$7{,}000 \approx 27.7\%$ — under the 28% example limit.
4. Total DTI: $(\$1{,}936.68 + \$600) \div \$7{,}000 = \$2{,}536.68 \div \$7{,}000 \approx 36.2\%$ — just over the 36% example limit.

Answer: PITI is $1,936.68. The family passes the 28% housing test but slightly misses the 36% total-debt test in this example — paying off part of the $600 in other debts, or a larger down payment, would fix it.

PRACTICE

1. Easy What is the annual simple interest on $150,000 at 7%? What is one month's interest?

   Show answer

   $\$150{,}000 \times 0.07 = \$10{,}500$ a year; one month is $\$10{,}500 \div 12 = \$875$.

2. Easy How much do 3 discount points cost on a $180,000 loan for a $225,000 house?

   Show answer

   $3\% \times \$180{,}000 = \$5{,}400$. Points are always figured on the loan amount, not the price.

3. Easy What does each letter of PITI stand for, and which two parts are usually paid through an escrow account?

   Show answer

   Principal, interest, taxes and insurance. The taxes and insurance are usually collected monthly into the escrow (impound) account and paid by the servicer when due.

4. **Medium** A $160,000 loan at 6% for 30 years has a monthly P&I payment of $959.28. How much of the first payment reduces principal?

Show answer

Interest is $\$160{,}000 \times 0.06 \div 12 = \$800$, so principal is $\$959.28 - \$800 = \$159.28$.

5. **Medium** A house sells for $250,000 and appraises for $260,000. What is the maximum 90% LTV loan, and what down payment is needed?

Show answer

Use the lesser value, the $250,000 price: $0.90 \times \$250{,}000 = \$225{,}000$, so the down payment is $25,000. The higher appraisal does not increase the loan.

6. **Medium** In a fully amortized, fixed-rate loan, what happens over time to the payment, the interest portion and the principal portion?

Show answer

The payment stays level. The interest portion decreases each month because the balance shrinks, and the principal portion increases by the same amount.

7. **Medium** Annual taxes are $4,200, annual insurance $1,080, and monthly P&I $1,650. What is PITI?

Show answer

$\$1{,}650 + \$4{,}200/12 + \$1{,}080/12 = \$1{,}650 + \$350 + \$90 = \$2{,}090$.

8. **Hard** Using example ratios of 28% and 36%, what is the most a buyer earning $84,000 a year can pay for PITI, and how much total monthly debt (including PITI) is allowed?

Show answer

Gross monthly income is $7,000. Housing: $0.28 \times \$7{,}000 = \$1{,}960$. Total debt: $0.36 \times \$7{,}000 = \$2{,}520$, so other debts above $560 would squeeze the allowable PITI below $1,960.

9. **Hard** A borrower can pay 2 points ($5,000) to lower the monthly payment by $80. How many months to break even, and when are the points a poor choice?

Show answer

$\$5{,}000 \div \$80 = 62.5$ months, about five and a quarter years. If the family expects to sell or refinance sooner, the points cost more than they save.

10. Hard A lender wants an effective yield of about 6.5% on a loan at a 6.25% note rate. Using the traditional exam rule of thumb, how many points will it charge?

Show answer

The gap is 0.25%, and the rule of thumb says each point raises yield about 1/8% (0.125%), so about 2 points. It is an approximation for exam problems, not how real loans are priced.

11. Challenge A $300,000 loan at 7% for 30 years has a P&I payment of $1,995.91. Find the balance after two payments.

Show answer

Month 1: interest $1,750.00, principal $245.91, balance $299,754.09. Month 2: interest $\$299{,}754.09 \times 0.07 \div 12 \approx \$1{,}748.57$, principal $247.34, balance about $299,506.75.

12. Challenge Over 30 years, the $200,000 loan at 6% ($1,199.10 a month) costs how much interest in total? Explain why a shorter term saves so much interest even with a higher payment.

Show answer

Total paid is $\$1{,}199.10 \times 360 \approx \$431{,}676$, so interest is about $231,676. A shorter term puts more of each payment toward principal from the start; since interest is charged on the remaining balance, the balance falls faster and every later month's interest is smaller.

COMMON MISTAKES

- Computing points on the sales price — one point is 1% of the loan amount.
- Using the sales price for LTV when the appraisal is lower — lenders use the lesser of price or appraised value.
- Forgetting to divide annual interest, taxes or insurance by 12 when building a monthly figure.
- Thinking the payment of a fixed-rate amortized loan rises or falls over time — the payment is level; only its interest and principal shares change.
- Treating 28% and 36% as law — they are traditional example ratios; real limits depend on the loan program and lender.
- Confusing discount points with origination fees — points buy down the rate as prepaid interest; an origination fee pays the lender for making the loan.

Make it a game · Point, Percent, Payment. A parent rolls two dice to make a loan amount in tens of thousands (a 4 and a 7 make $470,000; a 3 and a 3 make $330,000). Then the parent calls one of four challenges: “Points!” (how much do 2 points cost?), “Month one!” (interest at 6% for one month), “Down!” (down payment at 80% LTV if this is the price) or “Taxes!” (monthly share of a tax bill of 1% of the amount). Players race on scrap paper; first correct answer scores a point, and a forgotten ÷ 12 costs one. First to seven points wins and chooses Saturday’s breakfast.

Scripture. “For which of you, intending to build a tower, sitteth not down first, and counteth the cost, whether he have sufficient to finish it? Lest haply, after he hath laid the foundation, and is not able to finish it, all that behold it begin to mock him, Saying, This man began to build, and was not able to finish.” (Luke 14:28-30, KJV)

Our Lord’s builder does exactly what a qualifying ratio does: he sits down first and asks whether his income will carry the project to the end. PITI, the debt-to-income ratio and the total interest over thirty years are the modern way to count the cost before laying the foundation. Wise borrowing begins with honest arithmetic, done before the papers are signed.

5.3 Conventional, FHA, VA and USDA Loans

OBJECTIVES

- Classify a loan as conventional, government-insured (FHA) or government-guaranteed (VA or USDA), and explain what the government actually promises in each case.
- Distinguish conforming from nonconforming (jumbo) conventional loans and explain why Fannie Mae and Freddie Mac standards matter.
- State when private mortgage insurance is commonly required and apply the Homeowners Protection Act's 80%, 78% and midpoint rules.
- Describe the FHA loan's mortgage insurance premiums, owner-occupancy rule and assumability, and the VA loan's eligibility, funding fee and no-down-payment feature.
- Identify who the USDA Rural Development guaranteed loan serves, and match a family's situation to the loan types that could fit it.

> **Warm-up.** List three things a lender worries about when it lends a stranger $300,000 for thirty years. Now imagine someone else promised to cover part of the lender's loss if the borrower failed. Which of your worries would that promise answer? Keep the list: it explains why mortgage insurance and government guaranties exist.

WATCH

Types of Mortgages: VA, FHA & Conventional | Real Estate Exam Prep

The Real Estate Classroom · 21:14

https://www.youtube.com/watch?v=i7ILn4FJMRU

> **WHEN TO WATCH**
> Watch in two halves after the big idea; build a three-column chart (Conventional, FHA, VA) and fill in who backs the loan, the down payment and the insurance or fee as he covers each.

BACKUP VIDEO

FHA Loans - What You Need To Know for the Real Estate Exam | Practice Question

PrepAgent · 5:00

https://www.youtube.com/watch?v=6N0M0lO_4FE

Watch before the practice set; pause at the practice question and answer it in your notebook before the reveal.

KEY TERMS

conventional loan

A mortgage loan that is not insured or guaranteed by any government agency; the lender (and any private mortgage insurer) bears the risk.

conforming loan

A conventional loan that meets the underwriting standards and loan limits set for purchase by Fannie Mae and Freddie Mac.

nonconforming (jumbo) loan

A conventional loan that does not meet Fannie Mae and Freddie Mac standards, most commonly because it exceeds the conforming loan limit.

private mortgage insurance (PMI)

Insurance from a private company protecting the lender against part of its loss if a borrower defaults, commonly required on conventional loans above 80% LTV.

Homeowners Protection Act of 1998

The federal law letting borrowers request PMI cancellation at 80% of original value and requiring automatic termination at 78% (or the loan's midpoint) for covered loans.

mortgage insurance premium (MIP)

The FHA's insurance charge, collected as an upfront premium (often financed into the loan) and an annual premium paid monthly.

certificate of eligibility (COE)

The VA document showing that a borrower qualifies for the VA home loan guaranty and how much entitlement is available.

USDA guaranteed loan

A loan made by an approved lender and guaranteed by USDA Rural Development for moderate-income buyers in eligible rural areas, commonly with no down payment.

FHA-insured loan

A loan made by an approved private lender and insured by the Federal Housing Administration, part of HUD, against loss on default.

VA-guaranteed loan

A loan made by a private lender to an eligible veteran, service member or surviving spouse, with part of it guaranteed by the Department of Veterans Affairs.

VA funding fee

A one-time fee charged on most VA loans, which may be financed and from which some veterans, such as those receiving disability compensation, are exempt.

insured vs. guaranteed

FHA insures a lender against loss through an insurance fund paid for by borrowers' premiums; VA and USDA guarantee repayment of a portion of the loan.

CORE IDEAS

The story. On June 27, 1934, President Franklin Roosevelt signed the National Housing Act, and with it created the **Federal Housing Administration.** The country was in the fourth year of a depression; builders were idle, and lenders would make only short, half-value, balloon loans, if any. The FHA did not lend a dollar. Instead it offered lenders *insurance*: if a borrower defaulted on a loan that met FHA standards, the FHA's insurance fund — built from premiums the borrowers themselves paid — would cover the lender's loss. In exchange, the loan had to be long, fully amortized

and modest in payment, and the house had to meet FHA's written property standards and pass an FHA appraisal. Lenders who had refused 50% loans for five years began making long amortized loans with far smaller down payments. The insured, level-payment, long-term mortgage — the loan most Americans now assume is natural — was a 1934 invention.

How they figured it out. Insurance worked because it pooled risk. No lender could know which family would lose a job, but across thousands of loans the losses were predictable, and a small premium from each borrower could pay for them. Two more pieces followed. In 1938 the government chartered the Federal National Mortgage Association — **Fannie Mae** — to buy FHA-insured loans from lenders, giving them fresh cash to lend again (Lesson 5.5). And on June 22, 1944, the Servicemen's Readjustment Act — the GI Bill — let the Veterans Administration *guarantee* part of a home loan to a returning serviceman, so that a lender could lend him nearly the whole price with no down payment. Later, the Department of Agriculture applied the guaranty idea to rural buyers. Every loan in this lesson descends from those choices: who bears the risk, and what promise shifts it.

The big idea. Every home loan falls into one of two families. A **conventional loan** has no government insurance or guaranty; the lender bears the risk, sometimes sharing it with a private mortgage insurer. A **government-backed loan** is still made by a private lender, but a federal agency stands behind it: the FHA **insures** it, while the VA and USDA **guarantee** a portion of it. Conventional loans divide again. A **conforming loan** meets the standards and dollar limit for purchase by Fannie Mae and Freddie Mac, so it can be sold on the secondary market; a **nonconforming** loan does not — most often a **jumbo** loan above the conforming limit, which the lender keeps or sells to private investors. The conforming limit is set each year and is higher in expensive counties, so check the current figure rather than memorizing one.

On a conventional loan above 80% LTV, the lender commonly requires **private mortgage insurance**, which covers the top portion of its loss on default; the borrower pays the premium, usually monthly. The **Homeowners Protection Act of 1998** sets the exit rules for loans on single-family principal residences closed on or after July 29, 1999. The borrower may *request* cancellation when the balance reaches — or is scheduled to reach — 80% of the home's **original value** (generally the lesser of the price or the appraisal at purchase), provided the borrower asks in writing, is

current, has a good payment history, has no junior liens and can show the value has not fallen. The servicer must *automatically* end PMI when the balance is scheduled to reach 78% of original value, if the borrower is current, and in any event the month after the loan's midpoint. These rules do not govern FHA or VA loans, which have their own.

The **FHA loan** is built for owner-occupants with modest savings. Its features: a low minimum down payment (commonly 3.5% for borrowers whose credit qualifies, as of 2026 — check HUD for current terms); more flexible credit standards; a **mortgage insurance premium** in two parts — an *upfront* premium usually financed into the loan and an *annual* premium paid monthly; county-by-county maximum loan limits; an FHA appraisal and minimum property standards; and **assumability** — a qualified buyer may assume an FHA loan. The FHA does not lend money; approved lenders do. The **VA loan** serves eligible veterans, active service members and certain surviving spouses, who prove eligibility with a **certificate of eligibility**. A VA loan may require *no down payment* at all, has no monthly mortgage insurance, and charges a one-time **funding fee** that can be financed (some veterans, including those receiving service-connected disability compensation, are exempt). The home must be the veteran's residence, the VA appraisal produces a Notice of Value (long called a Certificate of Reasonable Value), and a VA loan may be assumed by a qualified buyer, veteran or not.

The **USDA guaranteed loan**, run by USDA Rural Development, helps moderate-income families buy in eligible rural areas, which the agency maps. Household income must fall under a limit set for the area, the home must be the family's primary residence, and the loan commonly needs no down payment; borrowers pay an upfront guarantee fee and an annual fee. USDA also makes some direct loans to lower-income rural families. Which loan fits whom is a matter of facts, not of one loan being best. A veteran with little cash may compare a VA loan's funding fee with an FHA loan's premiums; a buyer with 20% down may choose a conventional loan with no mortgage insurance at all; a family in a small town may qualify for USDA; a buyer of an expensive home may need a jumbo loan. The licensee's job is to know the categories well enough to send the buyer to a lender with good questions — never to choose the loan for them.

On the exam today. Expect the classification question: FHA *insures*; VA and USDA *guarantee*; conventional loans have *no* government backing — and the trap answer

says the FHA or VA "makes" the loan, when in fact approved private lenders do. Expect "Which loan may require no down payment?" — VA (and USDA); FHA requires a small one. Expect "Which loan requires a certificate of eligibility?" — VA. Expect PMI vs. MIP: PMI is private insurance on conventional loans; MIP is the FHA's upfront-plus-annual premium. Expect the Homeowners Protection Act numbers: request at 80%, automatic at 78%, based on *original* value, not today's market value. Expect conforming vs. jumbo: conforming meets Fannie Mae and Freddie Mac standards and limits. And expect assumability: FHA and VA loans are assumable by qualified buyers; most conventional loans are not, because of the due-on-sale clause from Lesson 5.1.

PICTURE STUDY



Resettled Farmer on Steps of New Home, Wabash Farms, Indiana, Arthur Rothstein, May 1938 · Black-and-white photograph (film negative), Farm Security Administration · Library of Congress, Prints and Photographs Division

Image: Wikimedia Commons, public domain

Arthur Rothstein (1915–1985) was one of the first photographers hired by the federal government's Farm Security Administration, which sent cameramen across the country in the 1930s to record rural life and the government's own housing programs. In May 1938 he photographed this farmer on the steps of a brand-new house at Wabash Farms, a federal resettlement project in Indiana. The house is not an FHA loan, but it belongs to the same moment: the decade when Washington decided to stand behind the American family home with insurance, guaranties and programs. Because it was made by a federal employee on the job, the photograph belongs to the public.

Look closely

- Notice how new everything is — the bright siding, the freshly planted shrubs, the bare yard. Find three details that say "this family has just moved in."
- Look at the house's simple, sturdy plan: steep roof, central chimney, modest windows. FHA's minimum property standards pushed builders toward exactly this kind of plain, well-built house.
- Find the man on the steps and the dog beside him. How does Rothstein make a small house feel like a big event?

- Look at the empty land around the house. Rural homeownership programs, from the 1930s to today's USDA loans, began on ground like this.

Talk about it

1. What would this family have needed to know about their loan or contract before they moved in? Name two questions they should have asked.
2. Why might a government decide to insure or guarantee home loans rather than simply lend the money itself?
3. Proverbs 24:27 says to prepare the field first and afterward build the house. How does that order apply to a young family deciding when to buy?

PROJECT

The Loan Program Comparison Chart

You will build a one-page comparison chart of the four loan families — conventional, FHA, VA and USDA — using only official sources, then run one pretend family through it. Every figure that changes yearly (loan limits, premium rates, fees, income limits) will be dated and labeled "as of" the day you looked it up. The chart becomes a reference page in your Pathway File; it teaches you to describe choices without making them for anyone.

You will need

- A large sheet of paper or a spreadsheet
- HUD's FHA pages (hud.gov), the VA home loan pages (va.gov) and the CFPB's "Buying a House" guide
- Your Loan Calculator Sheet from Lesson 5.2
- This lesson's key terms

Steps

1. Make four columns — Conventional, FHA, VA, USDA — and eight rows: who backs it, insured or guaranteed, who qualifies, minimum down payment, mortgage insurance or fee, owner-occupancy, assumable, and one "watch out" fact.
2. Fill each cell from the lesson first, in pencil.
3. Visit the official sites and confirm or correct each cell; write the date beside every number that changes yearly and mark it "example — check current figure."
4. Add a box explaining the Homeowners Protection Act rules (80% request, 78% automatic, midpoint) with one worked number example.
5. Invent a pretend buyer — income, savings, debts, location, service history — and use your Loan Calculator to price an FHA option and a conventional option at example rates.
6. Write a five-sentence neutral memo to the pretend buyer listing the loan types that could fit, the facts that decide among them, and the questions to

bring to two or three lenders. Do not recommend one.

7. Title the page “Loan Programs,” date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards — front: FHA, VA, USDA, conventional, conforming, jumbo, PMI, MIP, COE; back: one defining feature each, with “insures” or “guarantees” where it applies.
2. Draw a family tree of loans: “All loans” splits into “Conventional” (then conforming and jumbo) and “Government-backed” (then FHA-insured, VA-guaranteed, USDA-guaranteed).
3. Write a trap list titled “Who really lends?”: FHA does not lend, VA does not usually lend, USDA guaranteed loans come from approved lenders — private lenders make the loans.

KEY FORMULAS

$$\text{PMI request point} = 0.80 \times \text{Original value}, \quad \text{Automatic termination} = 0.78 \times \text{Original value}$$

$$\text{Upfront premium or fee} = \text{Base loan} \times \text{Example rate}$$

From history. The GI Bill’s home loan guaranty changed the map of America. The original 1944 law guaranteed half of a veteran’s home loan up to $2,000 — a sum that sounds tiny now but covered the lender’s risk on a modest house. Millions of returning servicemen bought homes in the following decade, and builders raised whole new neighborhoods to meet them. The guaranty has been raised many times since, and the program has remained available to every generation of veterans who qualifies.

WORKED EXAMPLES

Example 1. The Larsens bought a home for $250,000 that appraised at $255,000, with a conventional loan and PMI. At what balance may they request cancellation of PMI, and at what balance must the servicer end it automatically?

Show solution

1. Original value is generally the lesser of price and appraisal at purchase: $250,000.
2. Request point (80%): $0.80 \times \$250{,}000 = \$200{,}000$, with a written request, a good payment history, no junior liens and proof the value has not fallen.
3. Automatic termination (78%): $0.78 \times \$250{,}000 = \$195{,}000$ on the original amortization schedule, if they are current.
4. A rise in market value does not change these Homeowners Protection Act figures; they are tied to original value (a lender may offer other options, but the Act's floor is fixed).

Answer: Request at a balance of $200,000; automatic termination when the scheduled balance reaches $195,000 (or at the loan's midpoint if sooner).

Example 2. In this example, a buyer purchases a $300,000 home with an FHA loan, a 3.5% down payment and an upfront mortgage insurance premium of 1.75% of the base loan, financed into the loan. Find the down payment, base loan, upfront premium and total loan. (Premium rates change; these are example figures.)

Show solution

1. Down payment: $0.035 \times \$300{,}000 = \$10{,}500$.
2. Base loan: $\$300{,}000 - \$10{,}500 = \$289{,}500$.
3. Upfront premium: $0.0175 \times \$289{,}500 = \$5{,}066.25$.
4. Total loan with the premium financed: $\$289{,}500 + \$5{,}066.25 = \$294{,}566.25$; an annual premium will also be added to the monthly payment.

Answer: Down payment $10,500; base loan $289,500; upfront premium $5,066.25; total financed $294,566.25 — in this example.

Example 3. Match each pretend buyer to the loan types that could fit, and name the feature that decides it: (1) a recently discharged Army sergeant with good credit and $4,000 in savings; (2) a nurse with 22% to put down on a suburban house; (3) a young couple of moderate income buying in a small farming town; (4) a surgeon buying a home priced well above the local conforming limit.

Show solution

1. (1) VA is possible — with a certificate of eligibility, no down payment may be required and there is no monthly mortgage insurance, though a funding fee usually applies. FHA is another option to compare.
2. (2) Conventional fits — with more than 20% down the LTV is under 80%, so no PMI is commonly required.
3. (3) USDA Rural Development is worth checking — if the town lies in an eligible area and household income is under the limit, a guaranteed loan may need no down payment.
4. (4) A jumbo (nonconforming) conventional loan — the amount exceeds what Fannie Mae and Freddie Mac buy.

Answer: (1) VA (or FHA); (2) conventional without PMI; (3) USDA if eligible; (4) jumbo conventional. The deciding facts are service, down payment, location and income, and loan size — and the final choice belongs to the borrower and lender.

PRACTICE

1. Easy What makes a loan “conventional”?

   Show answer

   It is not insured or guaranteed by any government agency. The lender bears the risk, sometimes sharing it with a private mortgage insurer.

2. Easy Which government loan program insures loans, and which programs guarantee them?

   Show answer

   The FHA insures loans through an insurance fund paid by borrowers’ premiums. The VA and USDA Rural Development guarantee a portion of the loan.

3. **Easy** What document shows that a veteran qualifies for a VA-guaranteed loan?

Show answer

The certificate of eligibility (COE), which also shows the veteran's available entitlement.

4. **Medium** A buyer makes a 10% down payment on a conventional loan. Will PMI commonly be required? Why?

Show answer

Yes. The LTV is 90%, above the common 80% threshold, so the lender commonly requires private mortgage insurance to cover part of its loss if the borrower defaults.

5. **Medium** What is the difference between a conforming loan and a jumbo loan?

Show answer

A conforming loan meets Fannie Mae and Freddie Mac standards and is within their dollar limit, so it can be sold to them. A jumbo loan exceeds that limit and is nonconforming, so the lender keeps it or sells it to private investors.

6. **Medium** Name the two parts of the FHA mortgage insurance premium and how each is commonly paid.

Show answer

An upfront premium, usually financed into the loan at closing, and an annual premium divided into monthly installments added to the payment.

7. **Medium** A home was bought for $320,000 and appraised at $315,000. Under the Homeowners Protection Act, at what balance may the borrower request PMI cancellation?

Show answer

Original value is the lesser figure, $315,000. The request point is $0.80 \times \$315{,}000 = \$252{,}000$, with the Act's conditions met.

8. Hard A non-veteran wants to buy a veteran's home and take over the veteran's VA loan. Is that possible? What should the veteran understand?

Show answer

Yes — VA loans are assumable by qualified buyers, veteran or not, with lender approval. The veteran should understand that his VA entitlement may stay tied to that loan unless an eligible veteran buyer substitutes entitlement, and that he should seek a release of liability.

9. Hard A borrower's home value has risen sharply, and the balance is now 70% of today's value but 85% of original value. Does the Homeowners Protection Act require the servicer to cancel PMI on request? Explain.

Show answer

No. The Act's request and automatic-termination points are measured against original value, and the balance is still 85% of it. The lender may have its own policy for cancellation based on a new appraisal, but the Act does not require it.

10. Hard In this example, a VA loan of $340,000 carries a funding fee of 2.15%, financed into the loan. What is the fee and the total loan? Why might a veteran with a service-connected disability pay nothing?

Show answer

$0.0215 \times \$340{,}000 = \$7{,}310$, making the loan $347,310. Veterans receiving compensation for service-connected disabilities are generally exempt from the funding fee; rates change, so check the VA's current table.

11. Challenge Explain how insurance pooling made the FHA's low-down-payment loans possible, and why the borrower, not the taxpayer, pays the premium.

Show answer

No lender can predict which borrower will default, but across many thousands of loans the rate of loss is predictable. Small premiums from every FHA borrower fund an insurance pool that covers lenders' losses, so lenders accept small down payments. Because the borrowers receive the benefit — loans they could not otherwise get — the program charges them for the protection.

12. **Challenge** Compare, in four sentences, how a buyer with 3.5% down, a buyer with 0% down and a buyer with 25% down might each be served by the four loan families — without recommending any.

Show answer

The 3.5% buyer could consider FHA, or a conventional loan with PMI if available at that LTV. The 0% buyer could qualify only through VA (if eligible) or USDA (if the location and income fit). The 25% buyer could use a conventional loan with no mortgage insurance, though FHA or VA remain possible. Each should compare total costs — rates, premiums, fees — with several lenders.

COMMON MISTAKES

- Saying the FHA or VA makes the loan — approved private lenders make the loans; FHA insures them and VA guarantees part of them.
- Calling FHA protection a guaranty — FHA insures; VA and USDA guarantee.
- Thinking an FHA loan needs no down payment — VA and USDA loans may require none; FHA requires a small one.
- Measuring the PMI cancellation point against today's market value — the Homeowners Protection Act uses original value: request at 80%, automatic at 78%.
- Confusing PMI with MIP — PMI is private insurance on conventional loans; MIP is the FHA's upfront-and-annual premium.
- Calling every conventional loan conforming — only those meeting Fannie Mae and Freddie Mac standards and limits conform; jumbos do not.

> **Make it a game · Insure, Guarantee or Neither?.** Make three signs: INSURE, GUARANTEE and NEITHER. A parent reads clues one at a time — "certificate of eligibility," "upfront and annual premium," "private mortgage insurance," "rural area income limit," "jumbo," "GI Bill," "1934," "no government backing," "Notice of Value," "Fannie Mae conforming limit." Players race to hold up the right sign and name the loan type (FHA, VA, USDA or conventional). A correct sign earns one point; the correct loan type earns a second. Twelve clues make a round; the champion explains the difference between insure and guarantee in one sentence to end the game.

> **Scripture.** “Prepare thy work without, and make it fit for thyself in the field; and afterwards build thine house.” (Proverbs 24:27, KJV)
>
> Solomon puts the income first and the house second. Every loan program in this lesson — conventional, FHA, VA or USDA — asks the same question in its own way: is the household’s work prepared to carry the house? A good program can lower the down payment, but it cannot replace the steady work that pays the note.

5.4 ARMs, Balloons, Reverse Mortgages and Seller Financing

OBJECTIVES

- Compute an adjustable rate from its index and margin and apply initial, periodic and lifetime caps across several adjustments.
- Explain negative amortization and identify the loan features that can cause it — payment caps, graduated payments and some interest-only structures.
- Distinguish fully amortized, partially amortized (balloon) and interest-only loans, and the graduated-payment and growing-equity mortgages.
- Describe the HECM reverse mortgage — age 62 or older, FHA-insured, non-recourse, counseling required — and compare home equity loans with home equity lines of credit.
- Match construction, bridge, package, blanket, wraparound, purchase-money and open-end loans and the installment land contract to their defining features.

> **Warm-up.** Your phone plan costs $40 a month, but the contract lets the company raise it by up to $5 each year and never above $60. Write the highest bill you could see in years 2, 3, 4 and 5. You have just applied a periodic cap and a lifetime cap — the two limits that protect an adjustable-rate borrower.

WATCH

Types of Loans for the Real Estate Exam (Explained Simply)

US Realty Training · 20:26

https://www.youtube.com/watch?v=NN2Rij_QTkg

> **WHEN TO WATCH**
> Watch after the big idea; each time he names a loan, write it in your notebook with a four-word definition, then compare your list with this lesson's key terms.

BACKUP VIDEO

Real Estate Exam [National] 80, Adjustable Rate Mortgages Explained

Open Exam Prep · 3:55

https://www.youtube.com/watch?v=t0PjflTnM4c

A four-minute ARM review; watch before practice problems 4 and 11 and write index, margin and the three caps in order as he names them.

KEY TERMS

adjustable-rate mortgage (ARM)

A loan whose interest rate changes at set intervals according to an index plus a fixed margin, within any stated caps.

index and margin

The index is a published market interest rate that moves; the margin is the lender's fixed percentage added to it; together they make the fully indexed rate.

rate caps (initial, periodic, lifetime)

Limits on how much an ARM's rate may change at the first adjustment, at each later adjustment, and over the whole life of the loan.

negative amortization

An increase in the loan balance that occurs when the payment is less than the interest due and the unpaid interest is added to principal.

balloon payment

A final payment much larger than the regular payments, due because the loan was partially amortized or interest-only.

graduated payment mortgage (GPM)

A loan whose payments start low and rise on a schedule, often producing negative amortization in the early years.

growing equity mortgage (GEM)

A fixed-rate loan whose payments increase on a schedule, with every increase applied to principal so the loan is paid off early.

reverse mortgage (HECM)

A loan to a homeowner 62 or older, FHA-insured in the HECM program, that pays the owner from home equity and is repaid when the last borrower dies, sells or moves out; it is non-recourse.

home equity line of credit (HELOC)

An open-end loan secured by the home that lets the owner borrow, repay and borrow again up to a credit limit.

wraparound mortgage

A new, larger junior loan that "wraps" an existing loan; the borrower pays the wraparound lender, who keeps paying the underlying loan.

purchase-money mortgage

A loan used to buy the property it secures, most often a loan the seller "carries back" as part of the price.

installment land contract (contract for deed)

Seller financing in which the seller (vendor) keeps legal title until the price is paid, while the buyer (vendee) takes possession and equitable title.

CORE IDEAS

The story. In the week of October 9, 1981, the average rate on a 30-year fixed mortgage in Freddie Mac's weekly survey reached 18.63% — still the record. Inflation had driven every interest rate upward, and America's savings-and-loan associations were caught in a trap. They had lent depositors' money for thirty years at fixed rates of 6, 7 or 8 percent, but now they had to pay savers far more than that to keep their deposits. Every old loan on their books lost money every month. Regulators responded by letting lenders share the risk of changing rates with borrowers. The Federal Home Loan Bank Board had begun allowing savings associations to make adjustable loans within limits in 1979; in March 1981 the Comptroller of the Currency let national banks offer them; and in 1982 Congress passed the Alternative Mortgage Transaction Parity Act, opening the door nationwide. The **adjustable-rate mortgage** was born of a crisis, and its protections were born of the fear of the next one.

How they figured it out. An adjustable loan had to answer three questions to be fair. What will move the rate? A published **index** the lender cannot control — over the years, Treasury yields, cost-of-funds measures and, as of 2026, commonly the Secured Overnight Financing Rate (SOFR). How much will the lender earn above it? A fixed **margin**, written into the note and never changed. And how far can the rate travel? **Caps**. The answers became the ARM's permanent anatomy, and Regulation Z added disclosure: a lender offering an adjustable loan secured by a principal dwelling must give the applicant the federal *Consumer Handbook on Adjustable-Rate Mortgages* (or a suitable substitute) and a description of the loan program. The same years brought other "alternative" designs — graduated payments, growing equity, shared appreciation — each trying to fit a loan to a family's income rather than forcing the family to fit the loan.

The big idea. An ARM's rate is index + margin, called the **fully indexed rate**, recomputed at each adjustment date and then limited by caps. Most ARMs today are hybrids: fixed for an initial period, then adjusting. A "5/1" ARM is fixed five years, then adjusts every year; a "5/6" is fixed five years, then adjusts every six months. Caps come in three kinds, often written as three numbers like 2/2/5: an **initial cap** on the first change, a **periodic cap** on each later change, and a **lifetime cap** on the total rise above the start rate. Caps protect the borrower — but if an ARM caps the *payment* rather than the rate, the payment may fall short of the interest due, and the unpaid interest is added to the balance: **negative amortization**, a loan that grows while you pay it. Many ARMs also offer a **conversion option** to switch to a fixed rate on stated terms, and some start with a low "teaser" rate below the fully indexed rate.

Loans also differ in how — and whether — they repay principal. A **fully amortized** loan retires itself with level payments. A **partially amortized** loan's payments are figured as if over a long term, but the loan comes due sooner, leaving a **balloon payment**. An **interest-only** (straight or term) loan pays only interest, so the entire principal is a balloon at the end. A **graduated payment mortgage** starts with low payments that rise on a schedule, often with negative amortization at first — built for buyers whose incomes are expected to grow. A **growing equity mortgage** also has rising payments, but on a fixed rate with every increase going to principal, so it pays off years early. A **budget mortgage** simply includes taxes and insurance in the payment (PITI). The **reverse mortgage** runs backwards: in the FHA's **Home Equity Conversion Mortgage** (HECM), a homeowner 62 or older, after counseling with a

HUD-approved counselor, borrows against equity and receives a lump sum, monthly payments or a line of credit. The balance grows; it comes due when the last borrower dies, sells or no longer lives in the home, and the borrower must keep paying taxes and insurance and maintain the house. It is **non-recourse**: neither borrower nor heirs owe more than the home is worth.

Two loans tap equity for younger owners. A **home equity loan** is a closed-end second mortgage paid out once; a **home equity line of credit** (HELOC) is open-end, like a credit card secured by the house. Then come the special-purpose loans the exam lists. A **construction loan** is short-term interim financing paid out in **draws** as work is completed and inspected, then replaced by a permanent "takeout" loan. A **bridge (swing) loan** lets an owner buy a new home before the old one sells, secured by the old one. A **package mortgage** covers real property plus personal property such as appliances or furniture. A **blanket mortgage** covers several parcels, with a partial release clause for each lot. An **open-end mortgage** lets the borrower borrow more later, up to a stated limit, under the same instrument. A **wraparound mortgage** is a new junior loan that includes, or "wraps," an existing loan: the buyer pays the wrap lender (often the seller), who keeps paying the original loan — workable only if the underlying loan has no enforceable alienation clause.

Sellers can be lenders too. In **seller financing**, the seller "carries back" part of the price as a **purchase-money mortgage** or deed of trust: the buyer receives the deed at closing and gives the seller a note and a security instrument, just as with a bank. (Any loan used to buy the property it secures is technically a purchase-money loan, but the exam usually means the seller-carried kind.) The older form is the **installment land contract**, also called a **contract for deed** or land contract. Here the seller — the **vendor** — keeps *legal title* until the buyer has paid all or a stated part of the price; the buyer — the **vendee** — takes possession and *equitable title*, pays the taxes and insurance, and receives the deed only at the end. If the vendee defaults, the contract may allow forfeiture of the payments made, though many states now require notice, a cure period or even foreclosure-like procedures. Railroads sold millions of western acres on such terms in the nineteenth century; Lesson 7.4 returns to the contract itself.

On the exam today. Expect ARM arithmetic: add index and margin, then apply the caps in order — the trap answer applies only the lifetime cap and ignores the periodic one. Expect "Which component of an ARM never changes?" — the margin.

Expect “A loan whose balance increases” — negative amortization. Expect “A loan with a large final payment” — a balloon (partially amortized or interest-only). Expect matching: several parcels, blanket; personal property included, package; new junior loan over an existing one, wraparound; seller carries back financing, purchase-money mortgage; payments disbursed as work proceeds, construction loan; buying before selling, bridge loan. Expect the land contract trap: the *vendor* (seller) keeps legal title; the *vendee* (buyer) holds equitable title. And expect reverse-mortgage basics: HECM borrowers must be 62 or older, the program is FHA-insured, counseling is required, and the loan is non-recourse.

PICTURE STUDY



Millions of Acres: Iowa and Nebraska Lands for Sale on 10 Years Credit, Burlington & Missouri River Railroad Company (advertising poster), 1872 · Color lithograph poster, printed in Buffalo, New York · Library of Congress, Printed Ephemera Collection

Image: Wikimedia Commons, public domain

After the Civil War, Congress granted western railroads millions of acres of land, and the railroads sold that land to settlers to raise money and to fill their trains with farm freight. The Burlington & Missouri River Railroad printed posters like this one by the thousands in 1872. Read the terms: ten years' credit at 6% interest, with only interest due at first and the principal paid in installments beginning in later years. The railroad was a seller acting as lender — exactly the seller financing this lesson teaches — and many families who could never have borrowed from an eastern bank bought their farms on such terms.

Look closely

- Find the words "10 years credit" and "6 per ct interest." This is seller financing: the railroad sells the land and carries the loan itself.
- Read the smaller print about when principal payments begin. Early years of interest only, then installments — a partially amortized schedule in nineteenth-century language.
- Look at the engraved valley near the top. What is the poster promising the buyer, beyond the terms?

- Notice “Land exploring tickets sold.” The railroad wanted buyers to see the land first — a reasonable step before signing any long contract.

Talk about it

1. If a settler bought on these terms under an installment contract, who would hold legal title during the ten years, and what would happen if a drought made him miss payments?
2. Why would a railroad rather sell land on credit than wait for buyers with cash?
3. Proverbs says a good man leaves an inheritance to his children’s children. How might long-term debt — of any kind — help or hinder that goal?

PROJECT

The Loan Menu

You will build a two-page “loan menu” that a pretend real estate office could hand a client to explain, neutrally, the less common loan types — each with its definition, how its payment behaves over time, who it is designed for, and its main risk. Then you will add an ARM worksheet that runs a pretend loan through five years of adjustments under its caps. Together they form the alternative-financing page of your Pathway File.

You will need

- Paper or a spreadsheet; graph paper for payment sketches
- The CFPB’s pages on adjustable-rate mortgages and reverse mortgages
- Your Loan Calculator Sheet from Lesson 5.2
- This lesson’s key terms

Steps

1. List twelve loan types: ARM, balloon, interest-only, graduated payment, growing equity, reverse (HECM), home equity loan, HELOC, construction, bridge, wraparound and installment land contract.
2. For each, write one line each for: definition, how the payment behaves over time, who it is designed for, and its main risk.
3. Beside each, draw a tiny sketch of the balance over time — falling to zero, falling then a balloon, flat then a balloon, rising (negative amortization), and so on.
4. Build an ARM worksheet: start rate, margin, three caps, and five years of pretend index values you invent; compute each year’s rate as the lowest of the fully indexed, periodic and lifetime limits.
5. Rerun the worksheet with the index jumping 3 points in one year and record what the caps did.
6. Write a three-sentence neutral note on the reverse mortgage: who qualifies, what the borrower must keep doing, and what “non-recourse” means for the heirs.

7. Title the pages “Loan Menu,” date them and file them in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the twelve loan types — front: the name; back: the one feature that identifies it on an exam question.
2. Draw four small balance-over-time graphs labeled fully amortized, balloon, interest-only and negative amortization.
3. Write a trap list titled “ARM order of operations”: index + margin first, then the periodic cap, then the lifetime cap — and the margin never changes.

KEY FORMULAS

$$\text{Fully indexed rate} = \text{Index} + \text{Margin}$$

$$\text{New rate} = \min(\text{Index} + \text{Margin},\ \text{Old rate} + \text{Periodic cap},\ \text{Start rate} + \text{Lifetime cap})$$

$$\text{Wrap lender's annual spread} = (\text{Wrap balance} \times \text{Wrap rate}) - (\text{Underlying balance} \times \text{Underlying rate})$$

From history. The reverse mortgage has a longer history than most people think. A Maine savings bank is commonly credited with making a reverse mortgage in 1961 to the widow of a high-school football coach, letting her stay in her home. Congress authorized the FHA’s Home Equity Conversion Mortgage demonstration in the Housing and Community Development Act of 1987, and HUD insured the first HECM in 1989. Mandatory counseling was built in from the start, because Congress knew older owners were signing a contract unlike any loan they had seen.

WORKED EXAMPLES

Example 1. In this example, a 5/1 ARM starts at 5.00% with a margin of 2.75% and caps of 2/2/5 (initial, periodic, lifetime). At the first adjustment the index is 4.75%; at the second, 5.50%; at the third, 7.50%. Find the rate after each adjustment.

Show solution

1. First adjustment: fully indexed $4.75\% + 2.75\% = 7.50\%$; the initial cap allows at most $5.00\% + 2\% = 7.00\%$. New rate: 7.00%.
2. Second adjustment: fully indexed $5.50\% + 2.75\% = 8.25\%$; the periodic cap allows up to $7.00\% + 2\% = 9.00\%$, and the lifetime cap up to $5.00\% + 5\% = 10.00\%$. New rate: 8.25%.
3. Third adjustment: fully indexed $7.50\% + 2.75\% = 10.25\%$; the periodic cap allows 10.25%, but the lifetime cap stops it at 10.00%.
4. Check: the rate is always the lowest of the three limits — fully indexed, periodic and lifetime.

Answer: 7.00%, then 8.25%, then 10.00%.

Example 2. In this example, a seller owes $140,000 at 4% on a loan with no enforceable alienation clause. She sells for $250,000; the buyer pays $30,000 down and gives her a wraparound note for $220,000 at 7%. Ignoring principal reduction, what is the seller's first-year interest spread, and what yield does she earn on the $80,000 of her own equity she financed?

Show solution

1. Interest the buyer pays the seller: $\$220{,}000 \times 0.07 = \$15{,}400$.
2. Interest the seller pays on the underlying loan: $\$140{,}000 \times 0.04 = \$5{,}600$.
3. Spread: $\$15{,}400 - \$5{,}600 = \$9{,}800$.
4. Seller's own money in the wrap: $\$220{,}000 - \$140{,}000 = \$80{,}000$; yield $\$9{,}800 \div \$80{,}000 = 12.25\%$.

Answer: A spread of $9,800, about a 12.25% yield on her $80,000 — the reason wraps appeal to sellers, and the reason the underlying lender's alienation clause must be checked first.

Example 3. Exam style. A buyer purchases a farm on an installment land contract, pays for six years, lives on the land and pays the taxes. Which statement is correct?

A. The buyer holds legal title and the seller holds a lien

B. The seller holds legal title and the buyer holds equitable title

C. The buyer holds legal title once the contract is recorded

D. Neither party holds title until the last payment

Show solution

1. Identify the instrument: an installment land contract (contract for deed).
2. Under it, the vendor (seller) keeps legal title as security until the price is paid.
3. The vendee (buyer) has possession and equitable title — the right to receive legal title on completing the payments.
4. Recording the contract gives notice of the buyer's interest but does not transfer legal title; the deed comes at the end.

Answer: B. The vendor keeps legal title; the vendee holds equitable title and possession until the contract is paid and the deed delivered.

PRACTICE

1. Easy An ARM's index is 4.1% and its margin 2.5%. What is the fully indexed rate?

   Show answer

   $4.1\% + 2.5\% = 6.6\%$, before any caps are applied.

2. Easy Which part of an ARM's rate stays the same for the life of the loan?

   Show answer

   The margin. The index moves with the market; the margin is fixed in the note.

3. Easy What is a blanket mortgage, and what clause usually accompanies it?

   Show answer

   A single mortgage covering several parcels, commonly a developer's lots. It usually has a partial release clause letting each lot be released as it sells.

4. **Medium** An ARM at 6% has a 1% periodic cap and a 5% lifetime cap. The fully indexed rate at the next adjustment is 8.25%. What is the new rate?

Show answer

The periodic cap limits it to $6\% + 1\% = 7\%$. The lifetime cap (11%) is not reached, so the new rate is 7%.

5. **Medium** What is negative amortization, and how can a payment cap cause it?

Show answer

Negative amortization is a rising loan balance. If a payment cap keeps the payment below the interest due after a rate increase, the unpaid interest is added to principal, so the balance grows.

6. **Medium** How does a growing equity mortgage differ from a graduated payment mortgage, though both have rising payments?

Show answer

A GEM has a fixed rate and applies every payment increase to principal, so it pays off early. A GPM starts with payments too low to cover the interest, often causing negative amortization early, and rises to catch up.

7. **Medium** A couple buys a new home before selling their old one and borrows against the old home's equity for the down payment. What loan is this?

Show answer

A bridge (swing) loan — short-term financing secured by the old home, repaid when it sells.

8. **Hard** A widower, 70, has a HECM. He moves permanently to his daughter's home in another state. What happens to the loan, and can the lender pursue his other assets if the home sells for less than the balance?

Show answer

The home is no longer his principal residence, so the loan comes due and is usually repaid by selling the home. Because a HECM is non-recourse, neither he nor his heirs owe more than the home's value; FHA insurance covers any shortfall to the lender.

9. Hard Explain the difference between a purchase-money mortgage and an installment land contract from the buyer's point of view, especially regarding title.

Show answer

With a purchase-money mortgage the buyer receives the deed — legal title — at closing and gives the seller a note and mortgage. With an installment land contract the seller keeps legal title until the price is paid; the buyer has only equitable title and possession, and receives the deed at the end.

10. Hard A seller proposes a wraparound loan to a buyer, but the seller's existing loan contains a due-on-sale clause. What risk does this create?

Show answer

The underlying lender may discover the sale and call its loan due under the alienation clause. If the seller cannot pay it off, the underlying lender can foreclose, threatening the buyer's home despite the buyer's faithful payments to the seller.

11. Challenge In this example a 5/6 ARM starts at 4.5%, margin 3%, caps 2/1/5. The index is 3.4% at the first adjustment, 4.0% six months later, and 6.0% six months after that. Find each rate.

Show answer

First: $3.4 + 3 = 6.4\%$, initial cap allows 6.5%, so 6.4%. Second: $4.0 + 3 = 7.0\%$, periodic cap allows 7.4%, so 7.0%. Third: $6.0 + 3 = 9.0\%$, periodic cap allows 8.0%, lifetime 9.5%, so 8.0%.

12. Challenge A $100,000 interest-only loan at 6% runs five years. What is the monthly payment, what is owed at the end, and why does the exam call this a balloon?

Show answer

Monthly interest is $\$100{,}000 \times 0.06 \div 12 = \$500$. Because no principal is ever paid, the entire $100,000 is due in one final payment — a balloon, the defining feature of an interest-only (straight) loan.

COMMON MISTAKES

- Applying only the lifetime cap to an ARM — apply the initial or periodic cap at each adjustment, then check the lifetime cap.

- Thinking the margin changes — the index moves; the margin is fixed for the life of the loan.
- Saying a reverse mortgage makes heirs liable for any shortfall — a HECM is non-recourse; FHA insurance covers the lender's shortfall.
- Mixing up vendor and vendee on a land contract — the vendor is the seller who keeps legal title; the vendee is the buyer with equitable title.
- Confusing a package mortgage (includes personal property) with a blanket mortgage (covers several parcels).
- Believing a growing equity mortgage has negative amortization — the GPM can; the GEM pays extra principal and finishes early.

Make it a game · Cap It!. Set a start rate of 5% with caps 2/1/5 and a margin of 3. Each player takes a turn rolling one die: the roll minus 1 is the new index (a 6 makes the index 5%). Everyone computes the new rate — index plus margin, then the initial or periodic cap, then the lifetime cap — and writes it down secretly. Reveal together; each correct rate scores a point, and the player who catches someone else's missed cap scores a bonus. After five adjustments, the highest score wins; then play one round where a payment cap causes negative amortization and everyone explains what happened to the balance.

Scripture. "A good man leaveth an inheritance to his children's children: and the wealth of the sinner is laid up for the just." (Proverbs 13:22, KJV)

Many loans in this lesson reach into the future: an ARM whose payment may rise, a balloon that falls due years from now, a reverse mortgage that spends a home's equity across the owner's remaining years. None is wrong in itself, but each changes what is left for the next generation. Solomon's standard asks every borrower to look past the first payment to the inheritance.

5.5 The Secondary Market and Foreclosure

OBJECTIVES

- Distinguish the primary mortgage market from the secondary market, and name the kinds of lenders and loan originators in the primary market.
- State what Fannie Mae (1938), Ginnie Mae (1968) and Freddie Mac (1970) do, and explain how mortgage-backed securities return money to lenders.
- Describe the Federal Reserve's role as monetary policy rather than lending to homebuyers.
- Compare judicial and nonjudicial foreclosure, equitable and statutory redemption, and explain when a deficiency judgment is possible.
- Compare a deed in lieu of foreclosure, a short sale and an REO purchase, and name the special risks of buying distressed property.

> **Warm-up.** A neighborhood library has only 100 books, and every one is checked out for thirty years. How could it lend a book to anyone new? Write one sentence proposing a fix. Your answer probably looks like the secondary mortgage market: someone else buys the old loans so the lender has money to lend again.

WATCH

Judicial Foreclosure & Nonjudicial Foreclosure | Real Estate Exam

The Real Estate Classroom · 15:15

https://www.youtube.com/watch?v=42Gube0aqFk

> **WHEN TO WATCH**
> Watch after the fourth core idea; draw a two-column chart (Judicial / Nonjudicial) and fill in the instrument, who conducts the sale, how long it takes and whether a deficiency is usually possible.

BACKUP VIDEO

The Secondary Mortgage Market Explained | Fannie Mae, Freddie Mac, Ginnie Mae

PassBuddy · 11:44

https://www.youtube.com/watch?v=4kLyMHWuMPE

Watch with the second and third core ideas; as each agency appears, write "buys" or "guarantees" beside its name in your notebook.

KEY TERMS

primary mortgage market

The market in which lenders originate loans directly to borrowers — banks, thrifts, credit unions and mortgage bankers.

secondary mortgage market

The market in which existing mortgage loans are bought and sold, usually pooled into securities, returning cash to originating lenders.

mortgage banker vs. mortgage broker

A mortgage banker originates loans with its own or borrowed funds, usually sells them and often services them; a mortgage broker brings borrowers and lenders together for a fee but does not fund the loan.

Fannie Mae and Freddie Mac

Government-sponsored enterprises (1938 and 1970) that buy conforming loans from lenders and pool them into mortgage-backed securities they guarantee.

Ginnie Mae

The Government National Mortgage Association (1968), a government corporation within HUD that guarantees timely payment on securities backed by FHA, VA and USDA loans; it does not buy loans.

mortgage-backed security (MBS)

An investment backed by a pool of mortgage loans, whose investors receive the borrowers' principal and interest payments.

judicial foreclosure

Foreclosure through a lawsuit in court, ending in a court-ordered public sale, commonly conducted by the sheriff.

nonjudicial foreclosure

Foreclosure without a lawsuit under a power-of-sale clause, usually in a deed of trust, ending in a trustee's sale after statutory notices.

equitable vs. statutory redemption

Equitable redemption is the borrower's right to pay the debt and costs before the foreclosure sale; statutory redemption, allowed in some states, is the right to buy the property back for a period after the sale.

deficiency judgment

A court judgment making the borrower personally liable for the amount by which the foreclosure sale proceeds fall short of the debt, where state law allows it.

deed in lieu of foreclosure

A voluntary deed from the defaulting borrower to the lender, accepted in place of foreclosure; the lender takes title subject to any junior liens.

short sale

A sale of the property for less than the amount owed, with the lender's approval to accept the net proceeds; the lender may or may not waive the remaining balance.

CORE IDEAS

The story. In May 1932, John and Rosella Blaisdell lost their Minneapolis house at a foreclosure sale to the Home Building and Loan Association, which held their mortgage. Minnesota law gave them one year to redeem it by paying the sale price, but in the depth of the Depression no one had that money. In April 1933 the Minnesota legislature passed a Mortgage Moratorium Law letting a court extend the redemption period, and a local court gave the Blaisdells until May 1935, provided they paid $40 a month toward the taxes, insurance and interest. The lender argued that the law broke its contract. On January 8, 1934, in *Home Building & Loan Association v. Blaisdell*, the Supreme Court upheld the law by five votes to four: in a grave emergency, Chief Justice Charles Evans Hughes wrote, a state could reasonably and temporarily adjust the *remedy* — the timing of redemption — while the debt itself remained owed. The case still frames the two halves of this lesson: lenders need confidence that loans will be repaid, and borrowers need fair procedures when they cannot repay.

How they figured it out. The 1930s showed a second problem: lenders had no way to turn old loans back into cash. A savings association whose money was tied up in thirty-year mortgages could not lend to a single new family until those loans paid down. The answer was a market for the loans themselves. In 1938 the government chartered the Federal National Mortgage Association — **Fannie Mae** — to buy FHA-insured loans from lenders. In 1968 Congress split it: Fannie Mae became a shareholder-owned company, and the new Government National Mortgage Association — **Ginnie Mae** — stayed inside HUD, guaranteeing the first modern mortgage-backed securities in 1970. That same year Congress created the Federal Home Loan Mortgage Corporation — **Freddie Mac** — to buy loans from savings associations. Together they built the **secondary mortgage market**, and in 2008, after heavy mortgage losses, Fannie Mae and Freddie Mac were placed under federal conservatorship.

The big idea. In the **primary market**, lenders make loans to borrowers: commercial banks, savings associations (thrifts), credit unions and **mortgage bankers**, which originate loans, usually sell them and often keep **servicing** them — collecting payments and managing escrow — for a fee. A **mortgage broker** only brings borrower and lender together. In the **secondary market**, investors buy those loans. Fannie Mae and Freddie Mac buy *conforming* conventional loans, pool them and issue **mortgage-backed securities** whose investors receive the borrowers' payments, with the enterprise guaranteeing timely payment. **Ginnie Mae** buys no loans at all: it guarantees timely payment on securities that approved issuers create from FHA, VA and USDA loans, backed by the full faith and credit of the United States. The lender gets its cash back and lends again; that is why underwriting standards are so uniform — a loan must be saleable. And the **Federal Reserve**? It conducts monetary policy — open-market operations, the discount rate and its other tools — which influences interest rates throughout the economy, but it does not make or buy individual home loans for families.

When a borrower defaults, the acceleration clause makes the whole balance due, and the lender may **foreclose** — force a sale of the property to pay the debt. States use two main methods. In **judicial foreclosure** the lender files a lawsuit, records a **lis pendens** (notice of pending action), obtains a court judgment, and the court orders a public sale, commonly by the sheriff, which the court then confirms. It is the usual method for mortgages and takes months or years. In **nonjudicial foreclosure**, the trustee under a deed of trust uses its **power of sale**: after the notices the state statute requires — commonly a notice of default and a notice of trustee's sale, recorded, mailed and published — the trustee sells the property at public auction without any court case. It is faster and cheaper, and it is the common path in deed-of-trust states such as Washington and Oregon. A few states still allow **strict foreclosure**, in which the court simply sets a deadline to pay, after which title passes to the lender without a sale.

Two rights of **redemption** protect the borrower. The **equitable right of redemption** — Chancery's gift from Lesson 5.1 — lets the borrower save the property any time *before* the sale by paying the full debt, interest and costs; some states also allow **reinstatement**, curing only the missed payments and costs. The **statutory right of redemption**, which exists only in some states and usually after judicial sales, lets the borrower buy the property back for a set period *after* the sale, as the Blaisdells tried

to do. Sale proceeds pay the costs of sale first, then the foreclosing lender, then junior liens in order of priority, and anything left goes to the borrower. Foreclosing a senior lien generally wipes out junior liens on the property (property-tax liens survive). If the sale brings less than the debt, the lender may seek a **deficiency judgment** against the borrower personally — where state law allows it. Many states limit or bar deficiencies, especially after a nonjudicial trustee's sale, and some protect owner-occupied homes; the state course teaches your state's rule.

Lenders and borrowers often prefer to avoid the sale. In a **deed in lieu of foreclosure**, the borrower voluntarily deeds the property to the lender. It saves both sides time, but the lender takes title *subject to* every junior lien — a foreclosure would have wiped them out — so lenders refuse when other liens exist, and the borrower should get the lender's release of any deficiency in writing. In a **short sale**, the owner sells to a third party for less than is owed, and the lender agrees to accept the net proceeds. Approval can take months; every lienholder must consent; and unless the lender waives the remaining balance, the seller may still owe it. Forgiven debt can also carry tax consequences, so sellers should consult a tax professional — and licensees should not give tax or legal advice. Property that fails to sell at the foreclosure auction becomes the lender's **real estate owned (REO)** and is listed for sale. Buyers of distressed property face special issues: auction purchases often require cash and allow no inspection; title may carry problems; redemption periods may still run; occupants may still live there; REO homes are sold as-is; and short sales may collapse late.

On the exam today. Expect the agency question: Fannie Mae and Freddie Mac *buy* loans; Ginnie Mae *guarantees* securities backed by FHA, VA and USDA loans and buys none — the classic trap. Expect "Which is part of the primary market?" — a lender originating a loan — versus the secondary market, where existing loans are sold. Expect "The Federal Reserve's role" — monetary policy, never direct loans to homebuyers. Expect foreclosure matching: deed of trust with power of sale, nonjudicial trustee's sale; mortgage, judicial sale. Expect the redemption timing trap: *equitable* redemption comes *before* the sale; *statutory* redemption comes *after* it, and only where a statute grants it. Expect the deed-in-lieu trap: the lender takes subject to junior liens. Expect short-sale questions: the lender must approve, and the seller is not automatically released from the deficiency. And expect the proceeds order: costs, foreclosing lien, junior liens, borrower.

PICTURE STUDY



The Courtyard of the Exchange in Amsterdam, Emanuel de Witte, 1653 · Oil on panel · Museum Boijmans Van Beuningen, Rotterdam

Image: Wikimedia Commons, public domain

Emanuel de Witte (c. 1617–1692) is best known for luminous church interiors, but in 1653 he painted the busiest secular space in Amsterdam: the courtyard of the Exchange that Hendrick de Keyser had built in 1611. Every weekday at midday, merchants gathered under these arcades, each trade at its own numbered pillar, to buy and sell shares, bills, commodities and debts. It was one of the first places in the world where people routinely traded claims on future payments with strangers. This picture opens the lesson on the secondary market because that is what Fannie Mae, Freddie Mac and Ginnie Mae created for home loans: a place where a lender's promise of future payments can be sold, so that fresh money can be lent again.

Look closely

- Count the small groups of men talking. Each group is a market in miniature — buyers and sellers of something that will be paid later.
- Look at the tall clock tower. Trading at the Exchange began and ended by the clock, and every claim traded there had a due date, like a mortgage payment.
- Find the man in the red cloak among the black-clad merchants. Where does de Witte want your eye to rest, and why?

- Notice the deep shadow of the arcade in front and the bright courtyard beyond. De Witte places you at the edge of the market, looking in — as a homeowner usually is when a loan is sold.

Talk about it

1. Why would a merchant buy a claim to be paid in the future instead of keeping his money in cash?
2. When a lender sells your loan, what stays the same for you, and what might change?
3. Exodus 22 tells the lender to return a poor man's cloak by nightfall. What does that command suggest about how a lender — or a foreclosure law — should treat a borrower in trouble?

PROJECT

Follow the Loan, Follow the Default

You will make two flowcharts on one page. The first follows a pretend loan from the moment a borrower signs it through its sale on the secondary market into a mortgage-backed security, naming every party and what each receives. The second follows a pretend default from the first missed payment through either a nonjudicial or a judicial foreclosure in your own state, with the alternatives — reinstatement, short sale, deed in lieu — branching off at the right moments. It becomes the capstone page of your Pathway File's financing section.

You will need

- A large sheet of paper or a diagramming program
- Your Lesson 5.1 Loan Packet and Lesson 5.3 Loan Programs chart
- Your state's official statute or attorney-general summary of foreclosure procedure
- Colored pencils

Steps

1. Flowchart one: borrower → originating lender → servicer → Fannie Mae or Freddie Mac (conforming conventional) or a Ginnie Mae issuer (FHA/VA/USDA) → pool → mortgage-backed security → investors. Label what money or promise moves along each arrow.
2. Add a side box explaining in two sentences why the Federal Reserve does not appear on the flowchart.
3. Flowchart two: missed payment → notice of default → acceleration, then branch into nonjudicial (trustee's sale) and judicial (lawsuit, lis pendens, judgment, sheriff's sale) paths.
4. Mark on the timeline where the equitable right of redemption ends and, if your state has one, where a statutory redemption period runs.
5. Add three exit branches — reinstatement, short sale and deed in lieu — each with one sentence on its main advantage and its main risk to the borrower.

6. Look up your state's rule on deficiency judgments after the common foreclosure method and write it in a box, citing the official source and the date you checked.
7. Title the page "Follow the Loan," date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for Fannie Mae, Freddie Mac, Ginnie Mae, MBS, primary market, secondary market, mortgage banker and mortgage broker — back: what each does in one line, with the year where it applies.
2. Draw a timeline with the foreclosure sale as a bold vertical line: equitable redemption on the left, statutory redemption (some states) on the right.
3. Write a trap list titled "Buys or guarantees?": Fannie buys, Freddie buys, Ginnie guarantees; the Fed sets monetary policy and buys no home loans for families.

KEY FORMULAS

$$\text{Deficiency} = \text{Debt owed (with costs)} - \text{Net sale proceeds}$$

$$\text{Proceeds order: costs of sale} \rightarrow \text{foreclosing lien} \rightarrow \text{junior liens in priority} \rightarrow \text{owner}$$

From history. The Exchange in de Witte's painting stood near the Amsterdam Exchange Bank, founded in 1609 to keep honest accounts in sound money, and the Dutch East India Company, whose shares traded under these arcades from 1602. Three centuries later, American finance borrowed the same idea for home loans. In 1970 Ginnie Mae guaranteed the first modern mortgage pass-through security, letting investors buy a slice of thousands of home loans as easily as Amsterdam merchants once bought a share of a voyage.

Example 1. In this example, a judicial foreclosure sale of a home brings $260,000. Costs of sale are $12,000. The first mortgage (foreclosing) is owed $230,000; a second mortgage is owed $40,000. Distribute the proceeds and find any shortfall.

Show solution

1. Costs first: $\$260{,}000 - \$12{,}000 = \$248{,}000$ remaining.
2. Foreclosing first lien paid in full: $\$248{,}000 - \$230{,}000 = \$18{,}000$ remaining.
3. Second mortgage receives the remaining $18,000 of its $40,000; its lien on the property is extinguished by the senior foreclosure.
4. Shortfall to the second lender: $\$40{,}000 - \$18{,}000 = \$22{,}000$, now an unsecured debt the second lender may pursue if state law allows; nothing is left for the owner.

Answer: Costs $12,000; first lender $230,000; second lender $18,000; owner $0. The second lender is short $22,000, collectible from the borrower personally only where state law permits.

Example 2. A borrower in a state with a twelve-month statutory redemption period falls behind. The lender files suit in March; the sheriff's sale is held in October. Explain which redemption right the borrower has in September, which in November, and what each requires.

Show solution

1. September is *before* the sale: the borrower holds the **equitable right of redemption** and may stop the foreclosure by paying the full debt, accrued interest and costs (or, where allowed, reinstating by curing the default).
2. The October sale ends the equitable right.
3. November is *after* the sale: in this state the borrower holds the **statutory right of redemption** and may recover the property by paying the sale price plus interest and allowed costs within twelve months.
4. The sale buyer's ownership is not final until the statutory period expires — a key risk for anyone buying at such a sale.

Answer: September: equitable redemption (pay the debt before the sale). November: statutory redemption (pay the sale price within the statutory period). The sale is the dividing line.

Example 3. Exam style. The Morrows owe $330,000 and must move. Their lender approves a short sale at $300,000; selling costs are $24,000. The approval letter is silent on any remaining balance. Which is TRUE?

A. The lender receives $300,000 and the Morrows owe nothing more

B. The lender receives $276,000 and may still pursue the Morrows for the shortfall

C. The lender must foreclose before accepting less than the debt

D. The buyer becomes liable for the shortfall

Show solution

1. Net proceeds: $\$300{,}000 - \$24{,}000 = \$276{,}000$ go to the lender.
2. Shortfall: $\$330{,}000 - \$276{,}000 = \$54{,}000$.
3. A short sale does not automatically release the borrower; unless the lender waives the deficiency in writing (or state law bars it), the Morrows may still owe the $54,000.
4. The buyer takes title free of the loan and owes the lender nothing.

Answer: B. The lender nets $276,000; the $54,000 shortfall remains collectible unless waived in writing or barred by state law — which is why sellers should get the waiver in the approval letter.

PRACTICE

1. Easy What is the difference between the primary and secondary mortgage markets?

   Show answer

   In the primary market, lenders originate loans to borrowers. In the secondary market, existing loans are bought and sold — usually pooled into mortgage-backed securities — returning cash to lenders so they can lend again.

2. Easy Which of Fannie Mae, Freddie Mac and Ginnie Mae does not buy loans? What does it do instead?

   Show answer

   Ginnie Mae. It guarantees timely payment to investors on mortgage-backed securities made up of FHA, VA and USDA loans, with the full faith and credit of the United States.

3. Easy Who usually conducts the sale in a nonjudicial foreclosure?

Show answer

The trustee named in the deed of trust, using the power of sale, after the notices required by state statute — no court case is needed.

4. Medium How does a mortgage banker differ from a mortgage broker?

Show answer

A mortgage banker originates and funds loans, usually sells them on the secondary market and often keeps servicing them. A mortgage broker only brings borrower and lender together for a fee and does not fund the loan.

5. Medium Does the Federal Reserve make loans to homebuyers? What does it do that affects mortgage rates?

Show answer

No. The Fed conducts monetary policy — through open-market operations, the discount rate and its other tools — which influences interest rates and credit throughout the economy, including mortgage rates.

6. Medium Explain the difference between equitable and statutory redemption.

Show answer

Equitable redemption lets the borrower pay the debt, interest and costs before the foreclosure sale. Statutory redemption, granted only by some states, lets the borrower buy the property back for a set period after the sale.

7. Medium Why might a lender refuse a deed in lieu of foreclosure from a borrower who has a second mortgage and a judgment lien?

Show answer

A lender taking a deed in lieu takes title subject to junior liens, so it would inherit the second mortgage and the judgment lien. A foreclosure would wipe them out, so the lender may prefer to foreclose.

8. Hard A foreclosure sale nets $185,000 after costs. The foreclosing first lien is owed $190,000. A second mortgage is owed $25,000. What does each lender receive, and what is the first lender's deficiency?

Show answer

The first lender receives all $185,000 and is short $5,000; the second lender receives nothing and its lien is extinguished. Each may pursue the borrower for its shortfall only where state law allows deficiency judgments.

9. Hard A buyer purchases a house at a sheriff's sale in a state with a one-year statutory redemption period, then begins remodeling. What risk has the buyer taken?

Show answer

The former owner may redeem within the year by paying the sale price plus interest and allowed costs, taking the property back. The buyer's improvements could benefit the redeeming owner, so buyers commonly wait out the period before investing heavily.

10. Hard Name four special risks a buyer faces at a foreclosure auction that are not present in an ordinary sale.

Show answer

Cash or near-cash payment is usually required immediately; there is often no chance to inspect the interior; the property is sold as-is, possibly with title problems or surviving liens such as taxes; and occupants may still be living there, with any redemption period still running.

11. Challenge Trace how a single FHA loan to a family in Spokane might end up paying an investor in another state, naming each party.

Show answer

An approved lender originates the FHA-insured loan; a Ginnie Mae-approved issuer pools it with similar FHA, VA and USDA loans and issues a mortgage-backed security, which Ginnie Mae guarantees. An investor anywhere buys the security, and the servicer passes the family's monthly principal and interest through to the investor.

12. **Challenge** Using *Blaisdell*, explain the difference between changing a debt and changing a remedy, and why the Court's majority thought the difference mattered.

Show answer

The Minnesota law did not cancel or reduce the Blaisdells' debt; it only extended the time to redeem and required reasonable payments meanwhile. The majority held that a state could temporarily adjust the remedy in a grave emergency while keeping the obligation itself intact — the lender would still be paid, only later.

COMMON MISTAKES

- Saying Ginnie Mae buys loans — it guarantees mortgage-backed securities built from FHA, VA and USDA loans; Fannie Mae and Freddie Mac buy loans.
- Thinking the Federal Reserve lends to homebuyers — it sets monetary policy that influences rates.
- Reversing the redemption rights — equitable redemption comes before the sale; statutory redemption comes after it, and only where a statute grants it.
- Believing a deed in lieu wipes out junior liens — the lender takes title subject to them; foreclosure would have eliminated them.
- Assuming a short sale releases the seller from the shortfall — only a written waiver from the lender, or state law, does that.
- Confusing the two foreclosure methods — judicial foreclosure goes through court; nonjudicial foreclosure uses the trustee's power of sale under a deed of trust.

> **Make it a game · Before the Gavel, After the Gavel.** Lay a ruler across the table: it is the foreclosure sale. A parent reads cards — "equitable redemption," "statutory redemption," "reinstatement," "notice of default," "lis pendens," "deficiency judgment," "REO listing," "short sale approval," "deed in lieu," "sheriff's certificate" — and players race to place each card on the correct side of the ruler (before or after the sale). Then switch decks for agency cards and have players sort them into BUYS, GUARANTEES and SETS POLICY piles. A point per correct placement; the high scorer is crowned "Chief Justice" for the week.

Scripture. “If thou at all take thy neighbour’s raiment to pledge, thou shalt deliver it unto him by that the sun goeth down: For that is his covering only, it is his raiment for his skin: wherein shall he sleep? and it shall come to pass, when he crieth unto me, that I will hear; for I am gracious.” (Exodus 22:26-27, KJV)

The law of Moses allowed a lender to take a pledge, but it limited what the lender could do with it when the borrower’s need was great. Modern foreclosure law, with its notices, redemption rights and limits on deficiencies, works on a similar principle: the creditor’s right is real, but it is exercised within bounds. A licensee who handles distressed sales should remember there is a neighbor behind every default.

UNIT 5

Financing: Notes, Loans and Lenders

Very few families buy a house with cash. Nearly every sale you will ever help close depends on a loan, and a loan is three things at once: a **promise**, a **pledge** and a piece of **arithmetic**. In this unit you will learn all three. You will meet the **promissory note** and the two instruments that pledge a house for it — the **mortgage** and the **deed of trust** common in the Northwest — and the clauses inside them that decide what happens when a house is sold or a payment is missed. You will compute what a loan really costs: one month of **amortization**, the price of **discount points**, the **loan-to-value ratio** and the full **PITI** payment a lender tests against a family's income.

Then you will sort the loans themselves — conventional, FHA, VA and USDA, adjustable and fixed, balloon and reverse, bank-made and seller-carried — and follow a loan after closing, into the **secondary market** where Fannie Mae, Freddie Mac and Ginnie Mae keep money flowing back to lenders, and, when the promise fails, into **foreclosure**, redemption and the short sale. The stories run from an English judge explaining the "dead pledge" to a Minnesota couple whose case reached the Supreme Court in 1934. Keep your calculator next to your notebook, label every rate and fee "in this example," and remember the rule beneath it all: a licensee explains loans; the family and its lender choose them.

PREREQUISITES

- Can convert between percents and decimals and find a percent of a large number (2% of $236,000; 80% of $295,000) quickly and accurately
- Can explain the difference between legal title and equitable title and between real and personal property, from Units 1 and 2
- Can define a lien and explain lien priority and recording in general terms, from Lesson 2.5
- Has the exam notebook current and a basic calculator of the kind allowed at the testing center

MASTERY CHECKLIST

- ☐ I can tell the note from the security instrument and name every party to a mortgage and a deed of trust, including who holds legal title.
- ☐ I can match the acceleration, alienation, prepayment, defeasance, escalation, subordination and release clauses to the events that trigger them, and tell an assumption from a purchase "subject to."
- ☐ I can split one monthly payment of an amortized loan into interest and principal, and compute points, LTV, down payment and PITI.
- ☐ I can test a payment against example housing and debt-to-income ratios and explain what a credit score measures.
- ☐ I can classify conventional, FHA, VA and USDA loans as uninsured, insured or guaranteed, and apply the Homeowners Protection Act's 80% and 78% rules.
- ☐ I can compute an ARM's rate through several adjustments under initial, periodic and lifetime caps, and explain negative amortization and balloon payments.
- ☐ I can define the reverse mortgage, home equity loan and line, construction, bridge, package, blanket, wraparound and purchase-money loans and the installment land contract.

- ☐ I can explain what Fannie Mae, Freddie Mac and Ginnie Mae do, and compare judicial and nonjudicial foreclosure, the two redemption rights, deficiency judgments, deeds in lieu and short sales.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Consumer Financial Protection Bureau: Buying a House**: Free, official. The federal consumer agency's step-by-step guide to shopping for a mortgage, comparing loan types and understanding the costs. Use it throughout the unit, especially with Lessons 5.2 and 5.3. Ages 15 and up.
- **CFPB: Explore Interest Rates**: Free, official. An interactive tool showing how credit score, down payment, loan type and location change the range of rates lenders are offering today. Use it in Lesson 5.2's project to supply example rates — and date every figure you copy. Ages 15 and up.
- **HUD: FHA Loans and the History of the FHA**: Free, official. HUD's own account of the Federal Housing Administration from 1934 to today, linking to its current loan pages. Read it with Lesson 5.3's story, then use the linked pages to check current FHA terms for your Loan Programs chart. Ages 15 and up.
- **U.S. Department of Veterans Affairs: VA Home Loans**: Free, official. The VA's explanation of eligibility, the certificate of eligibility, funding fees and exemptions, and how the guaranty works. Use it in Lesson 5.3 to fill the VA column of your chart with dated, sourced figures. Ages 15 and up.
- **CFPB: What Is an Adjustable-Rate Mortgage?**: Free, official. A short, plain explanation of index, margin and caps, with links to the CFPB's pages on reverse mortgages and balloon loans. Read it with Lesson 5.4 before building your ARM worksheet. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

5.1	**Notes, Mortgages and Deeds of Trust**	3 sessions of 50 minutes
5.2	**Loan Arithmetic: Interest, Points, LTV and PITI**	3 sessions of 50 minutes

5.3 Conventional, FHA, VA and USDA Loans 3 sessions of 50 minutes

5.4 ARMs, Balloons, Reverse Mortgages and Seller Financing

3 sessions of 50 minutes

5.5 The Secondary Market and Foreclosure 3 sessions of 50 minutes

Unit 5 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Choose the one BEST answer. Figures marked “in this example” are examples: real rates, fees, caps and limits change, and the live ones come from the lender, HUD, the VA or the CFPB. Fourteen correct (70%) matches the common passing line, but aim higher.

1. **5 pts**

   In a mortgage, the borrower is called the:

   A. Mortgagee

   B. Mortgagor

   C. Beneficiary

   D. Trustee

2. **5 pts**

   Under a deed of trust, bare legal title to the property is held by the:

   A. Trustor

   B. Beneficiary

   C. Trustee

   D. County recorder

3. 5 pts

A homeowner deeds her house to her son without paying off the loan, and the lender demands the entire balance. The lender is relying on the:

A. Defeasance clause

B. Subordination clause

C. Escalation clause

D. Alienation clause

4. 5 pts

A buyer purchases a home “subject to” the seller’s existing mortgage and later defaults; the foreclosure sale leaves a deficiency. Who is personally liable for it?

A. The original borrower only

B. The buyer only

C. Both the buyer and the original borrower

D. Neither, because the property was sold

5. 5 pts

In this example, a $180,000 loan at 5% for 30 years has a monthly principal-and-interest payment of $966.28. How much of the first payment reduces the principal?

A. $750.00

B. $216.28

C. $966.28

D. $179,783.72

6. 5 pts

A buyer pays $280,000 for a home and borrows 80% of the price. The lender charges 2.5 discount points. The points cost:

A. $7,000

B. $5,600

C. $4,480

D. $2,800

7. 5 pts

A home sells for $350,000 and appraises for $340,000. The loan is $306,000. What is the loan-to-value ratio?

A. 87.4%

B. 85%

C. 90%

D. 92%

8. 5 pts

A lender’s total debt-to-income (back-end) ratio compares gross monthly income with:

A. Principal and interest only

B. The housing payment plus all other recurring monthly debt payments

C. Net income after taxes

D. Annual property taxes and insurance

9. 5 pts

Which loan may allow an eligible veteran to buy a home with no down payment?

A. FHA-insured loan

B. Conforming conventional loan

C. VA-guaranteed loan

D. Jumbo loan

10. 5 pts

Which statement about the Federal Housing Administration is correct?

A. It insures loans made by approved lenders against loss from default

B. It makes loans directly to first-time buyers

C. It guarantees loans only for veterans

D. It buys conforming conventional loans

11. 5 pts

Under the Homeowners Protection Act, a servicer must automatically terminate PMI on a covered loan when the balance is scheduled to reach:

A. 80% of the home's current market value

B. 80% of original value

C. 78% of the home's current market value

D. 78% of original value

12. 5 pts

In this example, an ARM starts at 4.00% with a margin of 2.50% and caps of 2/2/6. At the first adjustment the index is 4.25%. The new rate is:

A. 6.75%

B. 6.25%

C. 6.00%

D. 10.00%

13. 5 pts

A loan whose balance grows because the monthly payment does not cover all the interest due is experiencing:

A. Negative amortization

B. Acceleration

C. Defeasance

D. Subordination

14. 5 pts

A buyer's loan is secured by the condominium and by the refrigerator, washer and furniture sold with it. This is a:

A. Blanket mortgage

B. Wraparound mortgage

C. Open-end mortgage

D. Package mortgage

15. 5 pts

Under an installment land contract, during the payment period:

A. The vendor holds legal title and the vendee holds equitable title

B. The vendee holds legal title and the vendor holds a mortgage

C. A trustee holds legal title for the vendor

D. Title passes to the vendee when the contract is recorded

16. 5 pts

To obtain an FHA-insured Home Equity Conversion Mortgage, the youngest borrower must be at least:

A. 55

B. 62

C. 65

D. 70

17. 5 pts

Ginnie Mae's role in the secondary market is to:

A. Buy conforming conventional loans from lenders

B. Guarantee timely payment on securities backed by FHA, VA and USDA loans

C. Set the discount rate for member banks

D. Insure lenders against borrower default

18. 5 pts

A borrower in default pays the full balance, interest and costs two days before the scheduled foreclosure sale, and the sale is canceled. The borrower exercised the:

A. Statutory right of redemption

B. Right of rescission

C. Equitable right of redemption

D. Right of first refusal

19. 5 pts

A lender refuses a borrower's offer of a deed in lieu of foreclosure. The MOST likely reason is that:

A. Deeds in lieu are illegal in most states

B. The borrower would remain on title

C. The lender would have to pay the borrower's equity in cash

D. The property has junior liens that the lender would take title subject to

20. 5 pts

Which statement about a short sale is TRUE?

A. The lender must approve accepting less than the amount owed

B. The seller is automatically released from any remaining balance

C. The buyer assumes the seller's remaining debt

D. It is the same as a foreclosure auction

ANSWER KEY

1. B. The borrower gives the mortgage and so is the mortgagor; the lender who receives it is the mortgagee. Choosing A is the exam's favorite trap.
2. C. The trustor (borrower) conveys bare legal title to the trustee, who holds it for the beneficiary (lender) until payoff. The borrower keeps equitable title and possession.
3. D. The alienation (due-on-sale) clause is triggered by a transfer of the property. Defeasance operates at payoff; subordination concerns lien priority.
4. A. A buyer "subject to" the loan never promised to pay it, so only the original maker of the note is personally liable. An assuming buyer would be liable too.
5. B. Interest is $\$180{,}000 \times 0.05 \div 12 = \$750$, so principal is $\$966.28 - \$750 = \$216.28$. A is the interest portion; D is the new balance.
6. B. The loan is $0.80 \times \$280{,}000 = \$224{,}000$, and points are figured on the loan: $2.5\% \times \$224{,}000 = \$5{,}600$. A wrongly uses the price.
7. C. LTV uses the lesser of price or appraisal: $\$306{,}000 \div \$340{,}000 = 90\%$. A divides by the price, the common trap.
8. B. The back-end ratio adds PITI to car, student-loan, credit-card and similar recurring payments. The front-end (housing) ratio uses PITI alone; both use gross, not net, income.
9. C. A VA loan may require no down payment for a borrower with a certificate of eligibility. FHA requires a small down payment; conventional loans usually require one.
10. A. FHA insures; approved private lenders make the loans. VA guarantees veterans' loans; Fannie Mae and Freddie Mac buy conforming loans.
11. D. Automatic termination comes at 78% of original value on the original schedule, if the borrower is current. The borrower may request cancellation earlier, at 80% of original value; current market value does not govern either rule.
12. C. The fully indexed rate is $4.25\% + 2.50\% = 6.75\%$, but the 2-point initial cap limits the rate to $4.00\% + 2\% = 6.00\%$. D is the lifetime ceiling, not this adjustment.
13. A. When the payment falls short of the interest, the unpaid interest is added to principal and the balance rises — negative amortization, possible with payment caps and graduated-payment loans.

14. D. A package mortgage covers real property plus personal property. A blanket mortgage covers several parcels; a wraparound includes an existing loan.
15. A. The seller (vendor) keeps legal title until the price is paid; the buyer (vendee) has possession and equitable title and receives the deed at the end.
16. B. HECM borrowers must be 62 or older and must receive counseling from a HUD-approved counselor; the loan is non-recourse.
17. B. Ginnie Mae buys no loans; it guarantees mortgage-backed securities built from government-backed loans. A describes Fannie Mae and Freddie Mac; C the Federal Reserve; D the FHA.
18. C. Redemption before the sale is equitable redemption. Statutory redemption, where it exists, runs after the sale; rescission belongs to Truth in Lending (Lesson 6.1).
19. D. A lender accepting a deed in lieu takes the property subject to junior liens, which a foreclosure would have wiped out. Deeds in lieu are legal and common when no other liens exist.
20. A. A short sale needs the lender's (and any other lienholder's) approval. The seller is released from the shortfall only by a written waiver or state law, and the buyer takes free of the loan.

PORTFOLIO PIECE: MY PATHWAY FILE — THE FINANCING PAGES

Assemble the financing section of your Pathway File: the two-paper Loan Packet with its labeled note, deed of trust summary, seven clauses and your county's instrument type (5.1); the Loan Calculator Sheet, tested against the lesson's worked examples (5.2); the Loan Programs chart comparing conventional, FHA, VA and USDA loans with every changing figure dated and sourced, plus your neutral memo to a pretend buyer (5.3); the Loan Menu with its twelve balance sketches and the ARM worksheet run through five years of caps (5.4); and the "Follow the Loan" page with its secondary-market and foreclosure flowcharts and your state's deficiency rule (5.5).

Close the section with a one-page cover memo in your own words: explain to a pretend first-time buyer why the note is a promise and the deed of trust a pledge, what PITI and the debt-to-income ratio are really measuring, and why your job is to explain loans clearly rather than to choose one for them. Date every page; Unit 6 will build the closing on top of this financing.

LOOK FOR	WHAT IT MEANS
Loan Packet	Every party to the note and deed of trust is correctly labeled, all seven clauses carry an accurate triggering example, and the assumption, "subject to" and novation box is correct.
Loan Calculator	The sheet reproduces the worked examples exactly ($1,000.00 and $199.10; $236,000 and $4,720; $1,936.68), uses the lesser of price and appraisal for LTV, and labels 28% and 36% as example limits.
Loan Programs chart	Insured and guaranteed are used correctly, the Homeowners Protection Act rules are stated with a correct numerical example, every changing figure is dated and sourced, and the memo describes options without recommending one.
Loan Menu and ARM worksheet	All twelve loan types are defined accurately with correct balance sketches, and each ARM adjustment applies the initial or periodic cap and then the lifetime cap correctly.
Follow the Loan	The secondary-market flowchart distinguishes buying from guaranteeing, the foreclosure flowchart places equitable and statutory redemption on the correct sides of the sale, and the state deficiency rule is cited to an official source with a date.

LOOK FOR	WHAT IT MEANS
Cover memo	Written in the student's own voice, it explains note versus pledge, PITI and DTI accurately and states the licensee's role — to explain, not to choose — in plain language.

UNIT 6

Lending Law, Title and Closing

A house changes hands in a single afternoon, but behind that afternoon stand five centuries of law. In this unit you will learn the federal rules that make a home loan honest — the **Truth in Lending Act** with its annual percentage rate, advertising triggers and three-day **right of rescission**; the **Equal Credit Opportunity Act**; and **RESPA**, which forbids kickbacks and, joined with Truth in Lending in the **TRID** rule, gives every borrower a Loan Estimate and a Closing Disclosure on a strict clock of business days. Then you will learn how ownership itself moves: the essential elements of a valid **deed**, the promises of the general warranty deed and the silence of the quitclaim, the involuntary transfers from escheat to **adverse possession**, and the vocabulary of wills and probate.

The last two lessons follow the deed to the county record office and the closing table. You will see why **recording** gives notice to the world, how a title examiner reads a chain of title, and why buyers insure their titles after a Philadelphia buyer lost everything in 1868 through no one's fault. Finally you will sit in the closing agent's chair and work the arithmetic of **prorations**, **debits and credits**, the seller's net and the buyer's cash to close. The stories run from an English ceremony of turf and twig to the purchase of Alaska; the scriptures run from Abraham weighing silver at Hebron to Jeremiah sealing his deed before witnesses. Count business days carefully, keep your calendar beside your calculator, and treat every fee and rate as an example.

PREREQUISITES

- Can explain the note, the mortgage and the deed of trust and the parties to each, from Lesson 5.1
- Can compute one month's interest, points, LTV and PITI with the Loan Calculator Sheet from Lesson 5.2
- Can state the elements of a legal description and the meaning of legal and equitable title, from Units 1 and 2
- Has a printed calendar and a basic calculator ready, and the exam notebook current through Unit 5

MASTERY CHECKLIST

- ☐ I can distinguish the APR from the note rate, identify advertising triggering terms and the required disclosures, and decide whether a loan carries a right of rescission.
- ☐ I can list ECOA's protected bases, describe the adverse-action notice, and recognize predatory lending and mortgage fraud.
- ☐ I can apply RESPA Section 8 and the affiliated business arrangement rules to referral scenarios, and state the escrow cushion limit.
- ☐ I can count the TRID deadlines for the Loan Estimate and Closing Disclosure, name the three changes that restart the wait, and compute a tolerance cure.
- ☐ I can list the essential elements of a valid deed, rank the deed types by protection, and name the five covenants of a general warranty deed.
- ☐ I can classify voluntary and involuntary alienation, apply the elements of adverse possession with tacking, and use the vocabulary of probate correctly.
- ☐ I can decide priority under race, notice and race-notice recording acts and compare owner's, lender's, standard and extended title policies.
- ☐ I can prorate taxes, rent and dues by the 365-day and 360-day

methods, place each closing item in the right debit or credit column, and compute net to seller and cash to close.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **CFPB: Your Home Loan Toolkit**: Free, official. The booklet lenders must give every applicant for a home-purchase loan, with worksheets on choosing a loan and reading the Loan Estimate and Closing Disclosure. Read it with Lessons 6.2 and 6.5. Ages 15 and up.
- **CFPB: Loan Estimate Explainer**: Free, official. An interactive, page-by-page walk through a sample Loan Estimate, with downloadable sample forms for fixed and adjustable loans. Use it for Lesson 6.2's project. Ages 15 and up.
- **CFPB: Closing Disclosure Explainer**: Free, official. The companion walk-through of the five-page Closing Disclosure, line by line. Use it with Lesson 6.5 to match your pretend settlement statement to the real form. Ages 15 and up.
- **CFPB: Interactive Regulation Z**: Free, official. The full text of Regulation Z with the CFPB's official interpretations, searchable by section — the advertising rules (1026.24), rescission (1026.23) and TRID timing (1026.19). Use it in Lessons 6.1 and 6.2 to check any rule at its source. Ages 16 and up.
- **CFPB: TILA-RESPA Integrated Disclosure Resources**: Free, official. The CFPB's compliance page for TRID, with its small-entity compliance guide and timeline charts written for lenders and settlement agents. Skim the timing and tolerance sections after Lesson 6.2. Ages 16 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

6.1	**Truth in Lending and the Fair Lender**	3 sessions of 50 minutes
6.2	**RESPA, TRID and the Closing Disclosures**	3 sessions of 50 minutes
6.3	**Deeds and the Transfer of Title**	3 sessions of 50 minutes
6.4	**Recording, Title Search and Title Insurance**	3 sessions of 50 minutes

Unit 6 test

Closed book, closed notebook, basic calculator only; a blank calendar page is allowed. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Choose the one BEST answer. Figures marked “in this example” are examples: real fees, tax rates, statutory periods and local customs vary, and the live rules come from the CFPB, your state and your county. Fourteen correct (70%) matches the common passing line, but aim higher.

1. **5 pts**

   The annual percentage rate on a home loan is usually higher than the note rate because the APR:

   A. Includes finance charges such as discount points and origination fees

   B. Includes the property taxes and insurance

   C. Is computed on the sales price rather than the loan

   D. Includes the real estate commission

2. **5 pts**

   Which advertisement phrase requires the ad to disclose the down payment, the terms of repayment and the APR?

   A. “APR as low as 6.5%”

   B. “Financing available”

   C. “No closing costs”

   D. “Only $1,650 per month”

3. **5 pts**

   The three-day right of rescission under Regulation Z applies to:

   A. A purchase-money loan used to buy a principal residence

   B. A home equity line of credit secured by the borrower’s principal residence

   C. A loan to buy a rental duplex

   D. A refinance by the same lender with no new money

4. **5 pts**

A homeowner signs a refinance with a new lender on a Thursday, receiving all disclosures at signing; no holiday intervenes. The right of rescission expires at midnight on:

A. Sunday

B. Monday

C. Tuesday

D. Wednesday

5. **5 pts**

Which of the following is a protected basis under the Equal Credit Opportunity Act but NOT under the federal Fair Housing Act?

A. Familial status

B. Handicap

C. Race

D. Age

6. **5 pts**

A buyer asks his agent to tell the lender he will live in a house that he actually plans to rent out, to get an owner-occupant rate. This request is:

A. Acceptable if he moves in within a year

B. A matter only between the buyer and his lender

C. A request to help commit occupancy fraud

D. Permitted for FHA loans only

7. **5 pts**

Under RESPA Section 8, which payment is permitted?

A. A referral fee paid by one real estate broker to another for a cooperative referral

B. A fee paid by a title company to a broker for sending buyers

C. Gift cards from a lender to an agent for each referred borrower

D. A share of an inspection fee paid to the agent who recommended the inspector

8. 5 pts

Under the TRID rule, the lender must deliver or mail the Loan Estimate:

A. At the closing table

B. At least three business days before consummation

C. No later than the third business day after receiving the application

D. Within seven days after the appraisal

9. 5 pts

Two days before closing, which change requires a new Closing Disclosure and a new three-business-day waiting period?

A. The seller agrees to a $1,500 repair credit

B. The loan changes from a fixed rate to an adjustable rate

C. The recording fee rises by $40

D. The buyer’s homeowners insurance premium falls

10. 5 pts

In this example, the Loan Estimate showed $2,500 for recording fees and title services chosen from the lender’s list; at closing they total $2,830. The lender must refund:

A. $0

B. $330

C. $80

D. $250

11. 5 pts

RESPA limits the cushion a servicer may hold in a borrower’s escrow account to no more than:

A. One-sixth of the estimated annual disbursements

B. One-twelfth of the estimated annual disbursements

C. One-quarter of the estimated annual disbursements

D. One-half of the estimated annual disbursements

12. 5 pts

Which party to a deed must be legally competent for the deed to be valid?

A. The grantor

B. The grantee

C. Both the grantor and the grantee

D. The notary

13. 5 pts

An owner signs and notarizes a deed to his daughter but keeps it in his own desk, telling no one; it is found after his death. The deed is:

A. Valid, because it was notarized

B. Valid, because the daughter is identifiable

C. Valid once recorded by the daughter

D. Ineffective, because it was never delivered during the grantor's lifetime

14. 5 pts

Which deed gives the grantee the LEAST protection?

A. General warranty deed

B. Special warranty deed

C. Bargain and sale deed

D. Quitclaim deed

15. 5 pts

Which of the following is an example of involuntary alienation?

A. Escheat of an intestate owner's land to the state

B. A devise in a will

C. A gift deed to a child

D. A sale by general warranty deed

16. 5 pts

A tenant has farmed land under a written lease for 30 years and now claims title by adverse possession. The claim will most likely fail because the possession was not:

A. Open and notorious

B. Hostile

C. Continuous

D. Actual

17. 5 pts

Recording a deed in the county where the land is located gives:

A. Actual notice to the grantor’s neighbors

B. Title to the grantee

C. Constructive notice to the world

D. Validity to an otherwise defective deed

18. 5 pts

In a race-notice state, Owner deeds a lot to A, who does not record. Owner then deeds the same lot to B, who pays value without knowing of A’s deed but records only after A records. Who owns the lot?

A. B, because B had no notice

B. B, because B paid value

C. Owner, because he sold twice

D. A, because B did not record first

19. 5 pts

An owner’s title insurance policy protects the insured against:

A. Future liens the owner places on the property

B. Changes in zoning after closing

C. Covered defects in title that existed before the policy date

D. Declines in market value

20. 5 pts

In this example, annual property taxes of $4,380 are paid in arrears. Closing is April 30 (not a leap year), the seller owns the day of closing, and a 365-day year is used. The tax proration is:

A. $1,440, credit seller and debit buyer

B. $1,440, debit seller and credit buyer

C. $2,940, debit buyer and credit seller

D. $1,460, debit seller and credit buyer

ANSWER KEY

1. A. The APR expresses the total finance charge — interest plus points, origination fees and similar charges — as a yearly rate. Taxes, insurance escrows and the commission are not finance charges.
2. D. A payment amount is a triggering term. The APR alone, general phrases like "financing available," and "no closing costs" do not trigger further disclosure.
3. B. Rescission covers loans that place a security interest on a principal dwelling, such as a HELOC or a refinance with a new lender. Purchase-money loans, same-lender refinances without new money and non-residence loans are exempt.
4. B. For rescission, every day but Sundays and federal holidays counts: Friday is day 1, Saturday day 2, Sunday is skipped, Monday is day 3. Counting only weekdays gives the trap answer, Tuesday.
5. D. ECOA protects age (if the applicant can contract), marital status and public-assistance income, which the Fair Housing Act does not list. Familial status and handicap are Fair Housing Act classes; race is protected by both.
6. C. Misstating intended occupancy to obtain better terms is occupancy fraud, a federal crime. The agent must refuse and should involve the supervising broker if the buyer persists.
7. A. Section 8 expressly allows cooperative brokerage and referral arrangements between real estate brokers and agents. Payments from settlement-service providers for referrals, in any form, are prohibited kickbacks.
8. C. The Loan Estimate goes out within three business days after application. B describes the Closing Disclosure — the swap the exam loves.
9. B. Only an APR that becomes inaccurate beyond tolerance, a change in loan product, or an added prepayment penalty restarts the wait. The other changes require only a corrected disclosure at or before closing.
10. C. These charges share a 10% aggregate tolerance: $1.10 \times \$2{,}500 = \$2{,}750$, so the excess is $\$2{,}830 - \$2{,}750 = \$80$. B treats them as zero-tolerance.
11. A. The cushion may not exceed one-sixth of the year's estimated taxes and insurance — about two months. One-twelfth is the regular monthly deposit, not the cushion.
12. A. Only the grantor must be competent. The grantee need only be living (or an existing entity) and identifiable, so a minor may receive title.
13. D. Title passes only on delivery and acceptance during the grantor's life. Notarization serves recording, not validity, and recording cannot cure the lack

of delivery.

14. D. A quitclaim deed carries no warranties and conveys only whatever interest the grantor has, if any. The general warranty deed gives the most protection.
15. A. Escheat happens by operation of law when an owner dies without a will or heirs. A will, a gift deed and a sale are voluntary alienation.
16. B. Possession under a lease is by the owner's permission, so it is not hostile, and no length of permissive possession ripens into title.
17. C. Recording gives constructive notice and protects priority. Title passes on delivery, and recording cannot make a defective deed valid.
18. D. Under race-notice, a later purchaser prevails only if he had no notice and recorded first. B lacked notice but lost the race to record, so A prevails.
19. C. Title insurance looks backward: for a one-time premium it covers loss from covered defects existing before the policy date, such as forgery in the chain. It does not cover later acts, zoning or market value.
20. B. Daily rate $\$4{,}380 \div 365 = \$12$; seller's days $31 + 28 + 31 + 30 = 120$; $120 \times \$12 = \$1{,}440$. Taxes in arrears are owed by the seller for his time, so debit seller, credit buyer; A reverses the columns.

PORTFOLIO PIECE: MY PATHWAY FILE — THE CLOSING PAGES

Assemble the closing section of your Pathway File: the Fair Lending Field Guide with its triggering-term rules, rescission decision tree, ECOA list, red-flag table and audit of three real ads (6.1); the annotated sample Loan Estimate with its tolerance labels and the TRID calendar for a pretend purchase (6.2); the Anatomy of a Deed pages with a labeled recorded deed, your own pretend deed and the deed-type chart (6.3); the Chain of Title ladder traced through at least five conveyances, with its title report and cures (6.4); and the complete four-column Settlement Statement for a pretend sale, with every proration worked both ways and the books proved to balance (6.5).

Close the section with a one-page cover memo to a pretend first-time buyer, in your own words: what the three business days before closing are for, why an owner's title policy is worth its one-time premium, and how to read the debits and credits on the Closing Disclosure. Date every page; together with the Unit 5 financing pages, these documents carry a sale from application to recorded deed.

LOOK FOR	WHAT IT MEANS
Fair Lending Field Guide	Triggering terms, required disclosures and rescission rules are stated exactly, the rescission example counts Saturdays and skips Sundays correctly, and the ad audit quotes real credit terms accurately.
Loan Estimate and TRID calendar	Every closing cost on the sample is placed in the correct tolerance bucket, and the calendar uses the lender's business days for the Loan Estimate and the all-days-but-Sundays-and-holidays rule for the Closing Disclosure.
Anatomy of a Deed	All eight essential elements are identified on the recorded deed, validity is distinguished from recording, private information is protected, and the deed-type chart ranks protection correctly with the five covenants listed.
Chain of Title	At least five conveyances are traced with instrument numbers, every loan is matched to its release or flagged, and each cloud found is paired with the correct cure.
Settlement Statement	Every item is in the correct debit or credit column, prorations are worked by both the 365-day and 360-day methods with the stated day-of-closing convention, and net to seller and cash to close are computed and proved.

LOOK FOR	WHAT IT MEANS
Cover memo	Written in the student's own voice, it explains the three-day Closing Disclosure window, the owner's title policy and debits versus credits accurately and plainly, recommending no particular lender or company.

UNIT 6 · LENDING LAW, TITLE AND CLOSING · LESSON 6.1 OF 50 · 3 SESSIONS OF 50 MINUTES

6.1 Truth in Lending and the Fair Lender

OBJECTIVES

- Explain the purpose of the Truth in Lending Act and Regulation Z and distinguish the annual percentage rate from the note rate and the finance charge.
- Decide whether a real estate advertisement uses a triggering term and list the disclosures the ad must then include.
- Determine whether a transaction carries the three-day right of rescission and count the rescission deadline in business days.
- Name the bases on which the Equal Credit Opportunity Act forbids credit discrimination and describe the adverse-action notice.
- Recognize predatory-lending patterns and mortgage-fraud schemes, and summarize the CFPB's creation and the ability-to-repay rule.

> **Warm-up.** Two stores sell the same $600 bicycle on credit. Store A says "only $25 a week!" Store B says "12% interest." Which is cheaper? Write down why you cannot tell. Truth in Lending exists because, before 1968, borrowers faced exactly that puzzle with almost every loan they took.

WATCH

Truth in Lending Act (Regulation Z) | Real Estate Exam Prep Videos

The Real Estate Classroom · 11:22

https://www.youtube.com/watch?v=gNfYvdK26Lo

> **WHEN TO WATCH**
> Watch after the big idea; list every "trigger term" he names, then check your list against the four in this lesson's fourth core idea.

BACKUP VIDEO

Equal Credit Opportunity Act: What is it? Real estate license exam questions.

Real Estate License Wizard · 5:26

https://www.youtube.com/watch?v=u4HBgO3aIsc

Watch with the fifth core idea; pause at each exam question and answer it aloud, then compare his list of protected bases with Regulation B's list in this lesson.

Truth in Lending Act (TILA)

The 1968 federal law, Title I of the Consumer Credit Protection Act, requiring lenders to disclose the cost of consumer credit in standard terms before the borrower is bound.

Regulation Z

The regulation implementing the Truth in Lending Act, written by the Federal Reserve and, since 2011, administered by the CFPB.

finance charge

The total dollar cost of credit, including interest, discount points, origination fees and mortgage insurance, but excluding certain bona fide real estate charges such as title, appraisal and credit-report fees.

annual percentage rate (APR)

The cost of credit expressed as a yearly rate that includes interest and other finance charges, usually higher than the note rate.

triggering terms

Specific credit terms in an advertisement — the down payment, the number of payments or period of repayment, the amount of any payment, or the amount of any finance charge — that require full disclosure.

right of rescission

A borrower's right to cancel certain loans secured by a principal dwelling until midnight of the third business day after closing, delivery of the notice or delivery of the material disclosures, whichever is last.

Equal Credit Opportunity Act (ECOA)

The 1974 federal law, implemented by Regulation B, forbidding creditors to discriminate on any prohibited basis in any aspect of a credit transaction.

adverse action notice

The written notice a creditor must give an applicant it denies, stating the specific reasons or the right to learn them, generally within 30 days of a completed application.

predatory lending

Abusive lending practices — such as equity stripping, loan flipping and fee packing — that profit the lender at the borrower's expense.

mortgage fraud

A material misstatement or omission relied on by a lender, such as false income, a straw buyer, occupancy fraud or an inflated appraisal; it is a federal crime.

Consumer Financial Protection Bureau (CFPB)

The federal agency created by the Dodd-Frank Act of 2010 that since 2011 writes and enforces most federal consumer-finance rules, including TILA, RESPA and ECOA rules.

ability-to-repay rule

The CFPB rule, effective January 10, 2014, requiring most mortgage lenders to make a reasonable, good-faith determination, using verified information, that the borrower can repay the loan.

CORE IDEAS

The story. In 1960 Senator Paul Douglas of Illinois, a former economics professor, introduced a short bill with a simple idea: anyone who lends to consumers should have to tell them, in the same terms every other lender uses, what the credit really costs. Lenders of the day quoted prices any way they liked — "a dollar a week," "six percent add-on," "low monthly payments" — so that a borrower could not compare two offers or even know which one was cheaper. The bill failed. Douglas brought it back in every Congress for six years, held hearings across the country, and lost his Senate seat in 1966 before it passed. His colleagues carried it on, and on May 29, 1968, the Consumer Credit Protection Act became law; its Title I is the **Truth in Lending Act**. It took effect on July 1, 1969, with rules — **Regulation Z** — written by the Federal Reserve. Every Loan Estimate you will read in Lesson 6.2 is a descendant of Douglas's bill.

How they figured it out. Congress chose disclosure rather than price-setting. It did not tell lenders what to charge; it told them how to *say* what they charged. The key invention was a single, comparable number — the **annual percentage rate**, or APR — that folds interest and most other costs of credit into one yearly rate, so that two loans can be compared side by side. Around it the law built three more protections that the exam tests: rules for **advertising** credit terms, a cooling-off **right of rescission** for certain loans secured by a borrower's home, and penalties for lenders

who mislead. Six years later Congress added a fairness law: the **Equal Credit Opportunity Act** of 1974, which first barred credit discrimination based on sex or marital status and in 1976 was broadened to race, color, religion, national origin, age and the receipt of public assistance. Truth and fairness became the two pillars of federal lending law.

The big idea. TILA and Regulation Z apply to **consumer credit** — credit for personal, family or household purposes — offered by creditors who regularly extend it. Credit primarily for business, commercial or agricultural purposes is exempt, so a loan to buy a rental office building is not covered, while a family's home loan is. The heart of the disclosure is the difference between two rates. The **note rate** is the interest rate written in the promissory note. The **APR** expresses the total **finance charge** — interest plus discount points, origination fees, mortgage insurance premiums and other charges imposed as a condition of the loan — as a yearly rate, so it is usually higher than the note rate. Certain bona fide real estate charges are excluded from the finance charge: title examination and title insurance, surveys, appraisal and credit-report fees, document preparation and notary fees, and amounts placed in escrow for taxes and insurance. TILA does not set the rate or forbid any fee; it requires the truth about them.

TILA reaches advertising too. Under Regulation Z, an ad that states any of four **triggering terms** must also disclose more. The triggers: (1) the amount or percentage of any **down payment** ("only 5% down"; even "80% financing," which implies 20% down); (2) the **number of payments or period of repayment** ("30-year mortgage"); (3) the **amount of any payment** ("$1,450 a month"); and (4) the amount of any **finance charge**. Once any trigger appears, the ad must state the down payment, the terms of repayment over the full term (including any balloon), and the "annual percentage rate," using that term, with the fact that it may increase if it can. Statements that do *not* trigger: the APR alone, "no down payment," "no closing costs," "easy monthly payments" or "financing available." Regulation Z also governs the **right of rescission**: when a loan places a security interest on the borrower's *principal dwelling*, each owner may cancel it until midnight of the third business day after the latest of closing, delivery of the rescission notice or delivery of the material disclosures. For rescission, business days are all calendar days except Sundays and federal legal holidays, and if the notice or disclosures are never given, the right can last up to three years.

Who gets that right is a favorite exam question. Rescission applies to **refinances with a new lender**, home-equity loans and lines of credit, and other loans secured by a principal residence. It does *not* apply to a **residential mortgage transaction** — a loan to buy or build the home itself (a purchase-money loan) — nor to a refinance by the same lender except for any new money, nor to loans on vacation homes or rentals, which are not principal dwellings. Funds are not disbursed until the rescission period ends. The **Equal Credit Opportunity Act**, implemented by Regulation B, forbids discrimination in any part of a credit transaction on the basis of **race, color, religion, national origin, sex, marital status, age** (if the applicant can legally contract), the fact that income comes from **public assistance**, or the good-faith exercise of consumer-credit rights. A lender may not discount reliable part-time, alimony or child-support income the applicant chooses to rely on, may not ask about plans to have children, and must give an applicant who is denied an **adverse action notice** — generally within 30 days of a completed application — stating the specific reasons or the right to request them. Applicants must also receive copies of appraisals.

Federal law also targets abuse and fraud. **Predatory lending** includes **equity stripping** (lending against a home's equity to a borrower who cannot repay, expecting to take the house), **loan flipping** (repeatedly refinancing a borrower to collect new fees), **packing** (adding credit insurance and other products the borrower did not ask for), steering a borrower to a costlier loan than he qualifies for, and hidden balloon traps. **Mortgage fraud** is a lie a lender relies on: **occupancy fraud** (claiming an investment property will be one's home to get better terms), **straw buyers** (a person who lends a name and credit for someone else's purchase), **inflated appraisals**, false income or employment, and undisclosed side payments. It is a federal crime, and a licensee must never take part, however small the request. After the mortgage crisis of 2007–2008, Congress passed the **Dodd-Frank Wall Street Reform and Consumer Protection Act** on July 21, 2010; it created the **Consumer Financial Protection Bureau**, which opened on July 21, 2011 and now writes and enforces TILA, RESPA and ECOA rules. Its **ability-to-repay rule**, effective January 10, 2014, requires most mortgage lenders to verify income, assets, debts and credit and make a reasonable, good-faith determination that the borrower can repay; a **qualified mortgage** that meets the rule's standards receives a presumption of compliance.

On the exam today. Expect "The APR is generally higher than the note rate because it includes…" — the finance charges, such as points and origination fees. Expect advertising questions: "30-year mortgage" or "$1,450 a month" *triggers* full disclosure; an ad stating only the APR, or "no down payment," does *not*. Expect the rescission trap: a buyer who has just bought a principal residence with a purchase-money loan has *no* right of rescission; a homeowner refinancing with a new lender or taking a home-equity line *does*, until midnight of the third business day — and Saturdays count. Expect ECOA's list, and the distractors: ECOA protects *marital status, age and public-assistance income*, which the Fair Housing Act does not, while familial status and disability belong to fair housing. Expect fraud scenarios — a buyer asking you to say he will live in a house he plans to rent is asking you to help commit occupancy fraud. And expect the CFPB's role: created by Dodd-Frank, it now administers these laws.

PICTURE STUDY



The Moneylender and His Wife, Quinten Massys, 1514 · Oil on panel · Musée du Louvre, Paris

Image: Wikimedia Commons, public domain

Quinten Massys (1466–1530) was the leading painter of Antwerp when that city was becoming the financial capital of northern Europe. In 1514 he painted a moneylender weighing coins with a delicate balance while his wife, holding a book of devotions, is drawn to watch him. An early description records that the original frame bore a line from Leviticus calling for a just balance and equal weights. This picture opens the lesson on Truth in Lending because it asks the same question the law does: is the scale honest? A coin clipped or a weight shaved cheated the borrower in 1514; a hidden fee or a misleading advertisement does the same today.

Look closely

- Find the small balance in the moneylender's hand. Every coin had to be weighed because coins could be clipped — a reminder that a stated number is only as good as the honesty behind it.
- Look at the wife's prayer book and the direction of her eyes. What is competing for her attention?
- Find the convex mirror on the table and the tiny figure reflected in it. Someone outside the transaction is watching — as regulators and the public do today.

- Notice the shelves of papers and objects behind the couple: records, pledges and accounts, kept in plain sight.

Talk about it

1. What is the difference between telling a borrower the truth and telling a borrower only true things? Which does Regulation Z require?
2. Why would a lender who charges a fair price still benefit from a law that makes every lender disclose prices the same way?
3. Proverbs 11:1 calls a false balance an abomination. Where in your own life could you be tempted to use a “false balance” — in a sale, a promise or a report?

PROJECT

The Fair Lending Field Guide

You will write a two-page field guide a new licensee could keep in a desk drawer: how to read an ad for triggering terms, how to tell whether a borrower has a right of rescission, what ECOA forbids, and the red flags of predatory lending and mortgage fraud — with the right response to each. Then you will audit three real advertisements you find yourself. The guide becomes the lending-law page of your Pathway File.

You will need

- Paper or a word processor
- Three real home or home-loan advertisements from a newspaper, mailer or website (save copies without anyone's personal information)
- The CFPB's Regulation Z and Regulation B pages and this lesson's key terms
- A calendar for counting business days

Steps

1. Page one, section A: list the four triggering terms and the three required disclosures, with two examples of statements that trigger and three that do not.
2. Section B: draw a decision tree for rescission — Is it consumer credit? Is it secured by the principal dwelling? Is it a purchase-money loan or a same-lender refinance? — ending in "rescission: yes" or "no," with a counted three-business-day example.
3. Section C: list ECOA's prohibited bases and three things a loan officer may never do, plus the adverse-action notice rule.
4. Page two: make a red-flag table with eight rows — equity stripping, loan flipping, packing, steering, occupancy fraud, straw buyer, inflated appraisal, false income — each with a one-sentence description and the licensee's correct response.
5. Audit your three real ads: for each, quote the credit terms used, say whether any triggering term appears, and say whether the required disclosures are

present.

6. Add one paragraph on the CFPB and the ability-to-repay rule in your own words.
7. Title the guide “Fair Lending Field Guide,” date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the four triggering terms and the three required disclosures; on the back of each trigger, write one ad phrase that uses it.
2. Draw a two-column chart: “Rescission — YES” (refinance with a new lender, home-equity loan, HELOC on principal residence) and “Rescission — NO” (purchase-money loan, same-lender refinance without new money, vacation home, business loan).
3. Write a trap list titled “ECOA vs. Fair Housing”: marital status, age and public-assistance income belong to ECOA; familial status and disability belong to the Fair Housing Act; race, color, religion, national origin and sex appear in both.

> **From history.** The Consumer Credit Protection Act did more than create Truth in Lending. Its Title III limited how much of a worker’s wages could be garnished for debts, and later amendments added the Fair Credit Reporting Act (1970), the Equal Credit Opportunity Act (1974), the Fair Debt Collection Practices Act (1977) and the Electronic Fund Transfer Act (1978). Lawyers still call the whole family “the CCPA,” and the ECOA’s list of protected rights includes the good-faith exercise of any right under it.

Example 1. A broker's office drafts four online ads for a new subdivision. Which require the full Regulation Z disclosures? (1) "Homes from $389,900 — APR as low as 6.4%." (2) "Only 3.5% down!" (3) "Low monthly payments — financing available." (4) "30-year fixed financing for qualified buyers."

Show solution

1. Check each ad against the four triggers: down payment, number of payments or period of repayment, payment amount, finance charge.
2. Ad 1 states a price and the APR. The APR alone is not a trigger, and the price is not a credit term, so no further disclosure is required.
3. Ad 2 states the percentage of the down payment — a trigger. Ad 4 states a 30-year period of repayment — a trigger.
4. Ad 3 uses general phrases that do not state any specific credit term, so it does not trigger.
5. Ads 2 and 4 must add the down payment, the terms of repayment and the APR (with the fact it may rise, if it can).

Answer: Ads 2 and 4 trigger full disclosure; ads 1 and 3 do not.

Example 2. The Chens refinance their principal residence with a new lender and sign the loan documents on Friday, May 1, 2026, receiving the rescission notice and all disclosures at the table. No federal holiday falls in the period. When does their right of rescission expire?

Show solution

1. Rescission applies: the loan is secured by their principal dwelling and is not a purchase-money loan or a same-lender refinance.
2. For rescission, business days are all calendar days except Sundays and federal legal holidays.
3. Count from the day after signing: Saturday, May 2 is day 1; Sunday, May 3 does not count; Monday, May 4 is day 2; Tuesday, May 5 is day 3.
4. The right lasts until midnight at the end of Tuesday, May 5; the lender may disburse funds only after that.

Answer: Midnight on Tuesday, May 5, 2026 — Saturday counts, Sunday does not.

Example 3. Exam style. A loan officer reviewing a couple's application says, "I'll count only the husband's full-time salary, not the wife's steady part-time income — and are you two planning to have children soon?" He then denies the loan by phone and sends nothing in writing. Which law has he most clearly violated, and how?

Show solution

1. The questions and the treatment of income concern credit, not housing advertising, so the governing law is the Equal Credit Opportunity Act (Regulation B).
2. Discounting reliable part-time income because of who earns it discriminates on the basis of sex or marital status.
3. Asking about plans to have children is forbidden under Regulation B.
4. Denying the loan without a written adverse action notice stating the reasons (or the right to request them) violates ECOA's notice requirement.

Answer: The Equal Credit Opportunity Act — three ways: discounting part-time income, asking about childbearing plans, and failing to give an adverse action notice.

PRACTICE

1. Easy Does the Truth in Lending Act set a maximum interest rate? What does it require instead?

   Show answer

   No. TILA requires lenders to disclose the cost of credit — the finance charge and the APR — in standard terms so borrowers can compare loans; it does not set rates.

2. Easy Why is the APR on a home loan usually higher than the note rate?

   Show answer

   The APR includes not only interest but other finance charges, such as discount points, origination fees and mortgage insurance, expressed as a yearly rate.

3. **Easy** Name the four triggering terms in credit advertising.

Show answer

The amount or percentage of the down payment; the number of payments or period of repayment; the amount of any payment; and the amount of any finance charge.

4. **Medium** An ad says "Beautiful 3-bedroom home, $1,895 per month!" What must the ad add, and why?

Show answer

A payment amount is a triggering term, so the ad must also state the down payment, the terms of repayment and the APR (with the fact that it may increase, if it can).

5. **Medium** A family closes on the purchase of their first home with a new 30-year loan. Do they have a three-day right of rescission?

Show answer

No. A residential mortgage transaction — a loan to buy the principal residence — is exempt from the right of rescission.

6. **Medium** Which finance-related charges are excluded from the finance charge on a real estate loan?

Show answer

Bona fide and reasonable real estate charges such as title examination and title insurance, surveys, appraisal and credit-report fees, document preparation and notary fees, and escrow deposits for taxes and insurance.

7. **Medium** List the prohibited bases under the Equal Credit Opportunity Act.

Show answer

Race, color, religion, national origin, sex, marital status, age (if the applicant can contract), receipt of income from public assistance, and the good-faith exercise of rights under the Consumer Credit Protection Act.

8. Hard A homeowner signs a home-equity line of credit on Wednesday, November 25, 2026. Thanksgiving, a federal holiday, is Thursday, November 26. When does the rescission period end?

Show answer

Business days for rescission exclude Sundays and federal holidays. Thursday (holiday) does not count; Friday, November 27 is day 1, Saturday the 28th is day 2, Sunday is skipped, and Monday, November 30 is day 3 — so the right runs until midnight on Monday, November 30.

9. Hard A buyer asks you to tell his lender that he will live in a duplex he actually plans to rent out, because owner-occupant rates are lower. What is this, and what should you do?

Show answer

It is occupancy fraud — a material misstatement to a lender, which is a federal crime. Refuse to take part, explain that you cannot, and if he persists, consult your supervising broker; never submit or repeat the false statement.

10. Hard A lender refinances an elderly homeowner three times in two years, each time charging new points and fees and adding credit insurance she did not request. Name the predatory practices.

Show answer

Loan flipping (repeated refinancing to generate fees), packing (adding unrequested products such as credit insurance) and, as her equity is consumed by fees, equity stripping.

11. Challenge Explain why Congress chose disclosure (TILA) rather than a maximum rate to protect borrowers, and name one limit of a disclosure-only approach that later laws addressed.

Show answer

Disclosure lets borrowers compare offers and lets competition discipline prices without government setting the price of credit. Its limit is that a borrower may receive accurate disclosures and still take a loan he cannot repay — which the ability-to-repay rule later addressed by requiring lenders to verify repayment ability.

12. **Challenge** A refinance with a new lender closed, but the lender never gave the borrower the rescission notice. Eighteen months later the borrower wants to rescind. Is that possible? Explain.

Show answer

Yes. If the required notice or material disclosures were not delivered, the right of rescission does not expire after three days; it can last up to three years after consummation (ending sooner if the property is sold). The borrower may still rescind at eighteen months.

COMMON MISTAKES

- Giving a purchase-money borrower a right of rescission — rescission covers refinances with a new lender and home-equity loans on a principal dwelling, not loans to buy the home.
- Thinking an ad stating only the APR triggers full disclosure — the APR alone is not a trigger; the down payment, repayment period, payment amount and finance charge are.
- Counting rescission days as weekdays — for rescission, every calendar day counts except Sundays and federal legal holidays, so Saturday counts.
- Mixing up ECOA and fair housing — marital status, age and public-assistance income are ECOA bases; familial status and disability are Fair Housing Act classes.
- Believing TILA caps interest rates — it requires disclosure of the cost of credit, not a particular price.
- Treating a small misstatement to help a buyer qualify as harmless — any material lie a lender relies on is mortgage fraud, a federal crime.

> **Make it a game · Trigger or Not?.** A parent reads twenty short ad phrases aloud — “only 5% down,” “APR 6.9%,” “30-year mortgage,” “no closing costs,” “$1,200 a month,” “easy payments,” “80% financing,” “financing available,” “48 payments,” “no down payment.” Players hold up a TRIGGER card or a SAFE card on each phrase. A correct card earns a point; naming which of the four triggers it is earns a bonus. Round two: the parent describes loans (“HELOC on your home,” “loan to buy your first house,” “refinance with a new bank”) and players call RESCIND or NO RESCIND. Fifteen points wins.

> **Scripture.** “A false balance is abomination to the LORD: but a just weight is his delight.” (Proverbs 11:1, KJV)
>
> In Solomon’s day the cheat used a doctored scale; today he might use a misleading advertisement or a buried fee. Truth in Lending is a modern “just weight”: it requires every lender to measure the cost of credit the same honest way. A licensee who never shades the truth about a loan — in an ad, a conversation or an application — keeps a just weight before God and neighbor.

6.2 RESPA, TRID and the Closing Disclosures

OBJECTIVES

- Identify a federally related mortgage loan and explain what RESPA Section 8 forbids, including kickbacks, unearned fees and fee splits, and what it permits.
- State the conditions for a lawful affiliated business arrangement and the RESPA limits on escrow (impound) accounts.
- Apply the TRID timing rules: the Loan Estimate within three business days of application and the Closing Disclosure at least three business days before consummation.
- Name the three changes that require a new three-business-day waiting period and count business days correctly under each definition.
- Sort closing costs into the zero, 10% and unlimited tolerance categories and compute a lender's cure for a tolerance violation.

> **Warm-up.** A title company offers a real estate agent $200 for every buyer she sends its way. Write one sentence on who really pays that $200, and one sentence on why the buyer might never find out. You have just described the problem RESPA's Section 8 was written to stop.

WATCH

TILA vs RESPA vs TRID Explained | Must-Know Federal Laws for the Real Estate Exam

KJMETHOD REAL ESTATE EXAM PREP · 8:16

https://www.youtube.com/watch?v=GHaVNeGOUFY

> **WHEN TO WATCH**
> Watch at the start of Session 1; make a three-column chart headed TILA, RESPA and TRID and write what each law requires as she covers it.

BACKUP VIDEO

CFPB Loan Estimate

American Land Title Association · 21:16

https://www.youtube.com/watch?v=mn8uN4G7rKY

Watch during the project with the sample Loan Estimate open beside you; pause on each page and label the same lines on your copy.

KEY TERMS

Real Estate Settlement Procedures Act (RESPA)
The 1974 federal law, implemented by Regulation X, governing settlement of federally related mortgage loans — disclosures, kickbacks, escrow accounts and servicing.

federally related mortgage loan
A loan secured by a first or subordinate lien on one-to-four-family residential property made by a federally regulated or insured lender, or insured, guaranteed or sold to a federal agency or Fannie Mae or Freddie Mac — nearly every home loan.

Section 8 (anti-kickback rule)
RESPA's ban on giving or accepting any fee, kickback or thing of value for referring settlement-service business, and on splitting charges for services not actually performed.

affiliated business arrangement (AfBA)
A referral to a settlement-service provider in which the referrer has an ownership interest; lawful only with written disclosure, no required use and no payment beyond a return on ownership.

escrow (impound) account cushion

The extra amount a servicer may hold in an escrow account beyond projected bills, limited by RESPA to one-sixth of the year's estimated disbursements.

TRID (TILA-RESPA Integrated Disclosure) rule

The CFPB rule, effective October 3, 2015, that combined the TILA and RESPA mortgage disclosures into the Loan Estimate and the Closing Disclosure.

Loan Estimate

The three-page TRID form showing a loan's estimated terms, payments and closing costs, delivered or mailed no later than the third business day after the lender receives an application.

Closing Disclosure

The five-page TRID form showing the final loan terms and closing costs, which the borrower must receive at least three business days before consummation.

application (TRID)

The submission of six pieces of information — name, income, Social Security number, property address, estimated property value and loan amount sought — which starts the Loan Estimate clock.

tolerance

The limit on how much an actual closing cost may exceed its Loan Estimate figure: zero for some charges, 10% in the aggregate for others, unlimited for the rest.

Your Home Loan Toolkit

The CFPB's booklet for home buyers, which a lender must give an applicant for a purchase loan within three business days of application.

CORE IDEAS

The story. On May 18, 2011, two months before it officially opened its doors, the new Consumer Financial Protection Bureau posted two draft mortgage forms on its website and asked the public a question no federal agency had quite asked before: which of these can you actually understand? For decades a homebuyer had received four overlapping documents from two different laws — a Good Faith Estimate and an early Truth-in-Lending statement after applying, and a HUD-1 settlement statement

and a final Truth-in-Lending statement at closing — using different words for the same costs. Congress, in the Dodd-Frank Act, ordered them merged. The Bureau's "Know Before You Owe" project tested its drafts with consumers, lenders and brokers in Baltimore that same month, then in Los Angeles, Chicago, Albuquerque, Springfield and Birmingham, and received more than 27,000 comments online. The final rule was issued in 2013 and took effect on October 3, 2015. The two forms it produced — the **Loan Estimate** and the **Closing Disclosure** — are the documents your future clients will hold.

How they figured it out. The older half of the story is the **Real Estate Settlement Procedures Act**, signed on December 22, 1974. In the early 1970s, Congress heard testimony that closing costs were confusing, hard to compare and padded by referral payments: a lender, title company or attorney would pay whoever steered the borrower to them, and the borrower paid for it in higher fees without ever knowing. RESPA attacked the problem two ways — by requiring advance disclosure of settlement costs, and by flatly forbidding payments for referrals in **Section 8.** It also limited the escrow accounts lenders could require. HUD administered RESPA for nearly four decades; in 2011 Dodd-Frank moved it to the CFPB, which then integrated its disclosures with Truth in Lending's. The result is the acronym the exam uses: **TRID**, the TILA-RESPA Integrated Disclosure rule.

The big idea. RESPA applies to **federally related mortgage loans** — loans secured by one-to-four-family residential property that are made by federally regulated or insured lenders, or are insured or guaranteed by FHA or VA, or are sold to Fannie Mae, Freddie Mac or Ginnie Mae pools. In practice that is almost every home loan. Exempt are business, commercial and agricultural loans, temporary financing such as most construction loans, and certain loans on vacant land. **Section 8** says no person may give or accept any fee, kickback or thing of value for referring settlement-service business, and no one may split a charge except for services actually performed. Violations are federal crimes — fines up to $10,000 and up to a year in prison — and violators are liable to the borrower for three times the charge. Section 8 permits payment for services actually performed at fair value, and it expressly permits cooperative brokerage and referral arrangements *between real estate brokers and agents*; it forbids a broker taking a fee from a lender, title company or inspector for a referral. RESPA also forbids a seller from requiring the buyer to use a particular title insurer.

Two more RESPA rules round out the exam list. An **affiliated business arrangement** — say, a brokerage that owns part of a title company and refers buyers to it — is lawful only if three conditions are met: the referrer gives a written disclosure of the relationship and estimated charges at or before the referral; the consumer is not required to use the affiliate (with narrow exceptions); and the referrer receives nothing beyond a return on its ownership interest. Second, RESPA limits **escrow (impound) accounts.** The servicer may collect each month one-twelfth of the year's projected taxes and insurance, plus a **cushion** of no more than one-sixth of the year's estimated disbursements — about two months' worth. It must analyze the account each year, and if it finds a surplus of $50 or more for a borrower who is current, it must refund it within 30 days. At closing, the initial deposit is limited the same way.

TRID runs on two forms and two clocks. The clock starts with an **application** — six items: name, income, Social Security number, property address, estimated value and loan amount sought. The lender must deliver or mail the **Loan Estimate** no later than the **third business day** after receiving the application, counting days the lender is open for business, and it may charge no fee before then except a reasonable credit-report fee. For a purchase loan the lender must also provide the CFPB's booklet **Your Home Loan Toolkit** within the same three business days. The Loan Estimate must go out at least seven business days before consummation. The **Closing Disclosure** must be *received* by the borrower at least **three business days before consummation** (the day the borrower signs the note). For these waiting periods, a business day is every calendar day except Sundays and federal legal holidays. If the Closing Disclosure is mailed or emailed, it is presumed received three business days after it was sent, unless the lender has evidence of earlier receipt. Only three changes after delivery restart the three-day wait: the **APR becomes inaccurate** (generally by more than one-eighth of a percentage point on a regular loan, one-quarter on an irregular one); the **loan product changes** (say, fixed to adjustable); or a **prepayment penalty is added.** Other changes get a corrected Closing Disclosure at or before closing without a new wait.

Finally, the Loan Estimate must be made in good faith, and the rule measures good faith with three **tolerance** buckets. **Zero tolerance:** charges paid to the lender or mortgage broker (such as origination fees and points), to an affiliate of either, or to a third party the borrower was not allowed to shop for, and transfer taxes — these may not increase at all. **Ten-percent tolerance:** recording fees and third-party services

the borrower could shop for but chose from the lender's written list — their *total* may not rise more than 10% above the total estimated. **No limit:** prepaid interest, homeowners insurance premiums, amounts placed in escrow, and services the borrower shopped for on his own, off the lender's list — these need only be estimated in good faith with the best information available. If a charge exceeds its tolerance, the lender must refund the excess ("cure" it) to the borrower within 60 days after consummation. TRID covers most closed-end consumer mortgages; HELOCs and reverse mortgages use other disclosures.

On the exam today. Expect the Section 8 scenario: a broker accepting a gift, fee or "marketing payment" from a lender, title company or home inspector for referrals violates RESPA; a referral fee between two licensed brokers does not. Expect the AfBA question: disclosure, no required use, return on ownership only. Expect the escrow cushion — one-sixth, or two months. Expect TRID numbers and the trap of mixing them up: the Loan Estimate goes out within *three business days of application*; the Closing Disclosure must be *received three business days before consummation*. Expect "Which change requires a new three-day waiting period?" — APR beyond tolerance, a new loan product, or an added prepayment penalty; a change in the seller's credit or a small fee change does not. Expect tolerance sorting: a lender's origination fee is zero tolerance; recording fees sit in the 10% bucket; homeowners insurance has no limit. And remember the history: RESPA 1974, TILA 1968, TRID effective October 3, 2015, CFPB administering all three.

PICTURE STUDY



The Syndics of the Amsterdam Drapers' Guild, Rembrandt van Rijn, 1662 · Oil on canvas · Rijksmuseum, Amsterdam

Image: Wikimedia Commons, public domain

Rembrandt (1606–1669) painted this group portrait near the end of his life for the hall of the Amsterdam drapers' guild. The men were *staalmeesters* — sampling officials elected each year to inspect cloth and certify that it matched the quality promised, so that buyers could trust what they were paying for. They sit with the guild's book open before them and look up as though someone has just come in with a question. This picture opens the lesson on RESPA and TRID because these men did for cloth what the Loan Estimate and Closing Disclosure do for a mortgage: they checked that what was delivered matched what was promised, in public, by a standard everyone could know.

Look closely

- Find the open book on the red carpet. The officials compared each bolt of cloth against recorded samples — as a borrower compares the Closing Disclosure against the Loan Estimate.
- Count the men who look directly at you. Rembrandt makes the viewer the person being answered; who, in a closing, is owed that kind of attention?
- Look at the man half-rising from his chair. Is he about to speak, or to leave? Something in the meeting is happening right now.

- Notice the plain black clothes and the single rich carpet. What does the painting say about the seriousness of the work these men did?

Talk about it

1. Why would honest cloth merchants want an independent inspector, even though inspection sometimes cost them a sale?
2. Which TRID rule most resembles a sampling official's job — the tolerance rules, the waiting period or the standard forms? Defend your answer.
3. Exodus 23:8 warns that a gift blinds the wise. Why does a referral payment endanger an advisor's judgment even when the advisor means well?

PROJECT

Reading the Loan Estimate Line by Line

You will take the CFPB's sample Loan Estimate (or, with your parents' permission, a real one from your family's files with private numbers covered) and read it page by page, building an annotated study sheet. Then you will draw the TRID calendar for a pretend purchase and sort its costs into tolerance buckets. The annotated Loan Estimate and the calendar become the disclosure pages of your Pathway File.

You will need

- The CFPB's Loan Estimate explainer and its downloadable sample forms
- The CFPB booklet Your Home Loan Toolkit
- A printed calendar page for June (or any month) and colored pencils
- This lesson's key terms

Steps

1. Print or open a sample Loan Estimate. On page 1, circle and label the loan amount, note rate, monthly principal and interest, whether the rate can increase, whether there is a prepayment penalty or balloon, and the estimated cash to close.
2. On page 2, mark each closing cost with a Z (zero tolerance), 10 (10% aggregate) or U (unlimited), using this lesson's rules; note which services the borrower can shop for.
3. On page 3, find the APR and the total interest percentage, and write one sentence explaining why the APR differs from the note rate.
4. On a calendar, mark a pretend application date, the Loan Estimate deadline, the latest Closing Disclosure delivery date and the consummation date, using the correct business-day definition for each.
5. Add a box showing what would happen if, two days before closing, the loan changed from fixed to adjustable — and why.
6. Read Your Home Loan Toolkit's section on the Closing Disclosure and write three questions a buyer should ask if the Closing Disclosure differs from the

Loan Estimate.

7. Title the pages “Reading the Loan Estimate,” date them and file them in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for RESPA, Section 8, AfBA, escrow cushion, TRID, Loan Estimate, Closing Disclosure, tolerance and the six items of an application.
2. Draw a TRID timeline: Application → (3 business days) → Loan Estimate → … → Closing Disclosure received → (3 business days, Saturdays count) → Consummation.
3. Write a trap list titled “Three things restart the clock”: APR beyond tolerance, product change, prepayment penalty added — and nothing else.

KEY FORMULAS

$$\text{10\% tolerance cure} = \text{Actual total} - 1.10 \times \text{Estimated total} \quad \text{(if positive)}$$

$$\text{Escrow cushion} \le \tfrac{1}{6} \times \text{Estimated annual disbursements}$$

From history. Before TRID, the settlement statement every closing agent knew was the HUD-1, a two-page form introduced under RESPA in the 1970s whose numbered lines — 100s for the borrower’s summary, 400s for the seller’s, 700 for commissions, 1100 for title charges — became a common language of the closing table. Since October 2015 the Closing Disclosure has replaced it for most consumer purchase loans, but the HUD-1 is still used for some transactions, such as reverse mortgages, and many older licensees still think in its line numbers.

Example 1. The Garcias' purchase loan is scheduled to close (consummate) on Thursday, June 18, 2026. No federal holiday falls between June 11 and June 18. (a) If the lender hands them the Closing Disclosure in person, what is the latest day they can receive it? (b) If the lender emails it instead, what is the latest day it can be sent, assuming no proof of earlier receipt?

Show solution

1. For the Closing Disclosure, business days are all calendar days except Sundays and federal legal holidays.
2. (a) Count back three business days before Thursday the 18th: Wednesday the 17th, Tuesday the 16th, Monday the 15th. Received Monday, consummation may occur on Thursday, the third business day after delivery.
3. (b) An emailed disclosure is presumed received three business days after it is sent. To be received by Monday the 15th, count back three business days: Saturday the 13th, Friday the 12th, Thursday the 11th (Sunday the 14th is skipped).
4. So the lender must send it no later than Thursday, June 11 — Saturday counts, Sunday does not.

Answer: (a) Monday, June 15, in person. (b) Sent by Thursday, June 11, to be presumed received Monday, June 15.

Example 2. A lender receives a completed application — all six items — on Monday. The lender's offices are open Monday through Friday, and no holiday intervenes. By when must the Loan Estimate be delivered or mailed, and may the lender charge an appraisal fee on Tuesday?

Show solution

1. The Loan Estimate deadline is the third business day after the application is received, counting days the lender is open for business.
2. Tuesday is day 1, Wednesday day 2, Thursday day 3.
3. Before the borrower receives the Loan Estimate and indicates an intent to proceed, the lender may charge only a bona fide, reasonable credit-report fee.
4. So an appraisal fee on Tuesday is not allowed.

Answer: Delivered or mailed by Thursday. No appraisal fee may be charged until the borrower has the Loan Estimate and says to proceed — only a credit-report fee may be charged earlier.

Example 3. In this example, a Loan Estimate showed an origination fee of $1,500 ; recording fees and lender-list title services totaling $2,000; and homeowners insurance of $1,200. At closing the figures are $1,650, $2,300 and $1,400. How much must the lender cure?

Show solution

1. Origination fee — zero tolerance: $\$1{,}650 - \$1{,}500 = \$150$ must be refunded.
2. Recording fees and lender-list services — 10% aggregate tolerance: allowed up to $1.10 \times \$2{,}000 = \$2{,}200$; actual $2,300 exceeds it by $100.
3. Homeowners insurance — no limit, if estimated in good faith: the $200 increase needs no cure.
4. Total cure: $\$150 + \$100 = \$250$, refunded within 60 days after consummation.

Answer: $250 — $150 on the zero-tolerance origination fee and $100 on the 10% bucket; nothing on the insurance.

PRACTICE

1. Easy What does RESPA Section 8 prohibit?

Show answer

Giving or accepting any fee, kickback or thing of value for referring settlement-service business on a federally related mortgage loan, and splitting charges except for services actually performed.

2. Easy When must a lender deliver or mail the Loan Estimate?

Show answer

No later than the third business day after receiving the application, counting days the lender is open for business.

3. Easy How long before consummation must the borrower receive the Closing Disclosure?

Show answer

At least three business days, where business days are all calendar days except Sundays and federal legal holidays.

4. Medium A broker refers a buyer to another broker in a different city and receives a referral fee from that broker. Does this violate RESPA?

Show answer

No. Section 8 expressly permits cooperative brokerage and referral arrangements between real estate brokers and agents. It forbids referral payments from settlement-service providers such as lenders, title companies or inspectors.

5. Medium A brokerage owns 30% of a title company and refers its buyers there. What three conditions make this lawful?

Show answer

A written disclosure of the ownership relationship and estimated charges at or before the referral; no requirement that the buyer use the title company; and no payment to the brokerage beyond a return on its ownership interest.

6. Medium Annual taxes and insurance on a home total $4,800. What is the largest escrow cushion RESPA allows?

Show answer

One-sixth of the annual disbursements: $\$4{,}800 \div 6 = \$800$, about two months of the $400 monthly escrow payment.

7. Medium Name the six pieces of information that make up an “application” under TRID.

Show answer

The consumer’s name, income and Social Security number (to obtain a credit report), the property address, an estimate of the property’s value, and the loan amount sought.

8. Hard Two days before closing, the lender lowers the origination fee by $300 and the seller agrees to a $1,000 repair credit. Does either change require a new three-business-day waiting period?

Show answer

No. Only an APR that becomes inaccurate beyond tolerance, a change in loan product or an added prepayment penalty restarts the wait. These changes require a corrected Closing Disclosure at or before closing, but no new waiting period.

9. Hard A home inspector gives a listing agent a $50 restaurant gift card for each client the agent sends him. The agent says it is just “appreciation.” Is it a RESPA problem?

Show answer

Yes. Under Section 8, a thing of value given in exchange for referrals of settlement-service business is a prohibited kickback whatever it is called; the agent should refuse it and consult the supervising broker.

10. Hard In this example, the 10% tolerance bucket was estimated at $3,400 and comes in at $3,690 at closing. Is a cure owed? How much?

Show answer

The limit is $1.10 \times \$3{,}400 = \$3{,}740$. The actual $3,690 is within it, so no cure is owed even though individual charges rose.

11. **Challenge** Consummation is set for Tuesday, September 8, 2026, the day after Labor Day (Monday, September 7, a federal holiday). By what day must the borrower receive the Closing Disclosure in person?

    Show answer

    Count back three business days before Tuesday, skipping Sundays and the holiday: Monday the 7th (holiday) does not count, Sunday the 6th does not count, Saturday the 5th is day 1 back, Friday the 4th day 2, Thursday the 3rd day 3. It must be received by Thursday, September 3.

12. **Challenge** Explain why Congress chose to ban referral payments outright in Section 8 rather than merely requiring that they be disclosed.

    Show answer

    A referral payment adds nothing to the service but is built into its price, and the borrower, who relies on the referrer's advice, cannot see or bargain over it. Disclosure alone would leave the conflict of interest in place; a ban removes the incentive to steer borrowers to the provider that pays the referrer rather than the one that serves them best.

COMMON MISTAKES

- Mixing the two TRID clocks — the Loan Estimate goes out within three business days after application; the Closing Disclosure must be received three business days before consummation.
- Using the lender's office days for the Closing Disclosure wait — that wait counts every day but Sundays and federal holidays, so Saturdays count.
- Thinking any change restarts the three-day wait — only an APR beyond tolerance, a new loan product or an added prepayment penalty does.
- Believing all referral fees violate RESPA — fees between real estate brokers are expressly permitted; fees from lenders, title companies and other settlement-service providers are not.
- Applying the 10% tolerance to each fee separately — the 10% bucket is measured in the aggregate.
- Stating the escrow cushion as one month — RESPA allows up to one-sixth of annual disbursements, about two months.

Make it a game · Bucket Brigade. Set out three bowls labeled ZERO, TEN and NO LIMIT. A parent reads closing-cost slips — origination fee, discount points, transfer tax, recording fee, title service from the lender's list, title service the buyer found himself, homeowners insurance, prepaid interest, escrow deposit, appraisal by the lender's affiliate. Players race to drop each slip in the right bowl. Then flip to the clock round: the parent names an event ("product changes to an ARM," "seller credit added," "APR jumps half a point," "prepayment penalty added") and players shout RESTART or NO RESTART. Most points wins.

Scripture. "And thou shalt take no gift: for the gift blindeth the wise, and perverteth the words of the righteous." (Exodus 23:8, KJV)

This verse is RESPA Section 8 in a single sentence. A referral payment does not have to be a bribe to corrupt judgment; it only has to make the advisor see the paying provider more kindly than the client deserves. A licensee who refuses such gifts keeps both the law and his own clear sight.

6.3 Deeds and the Transfer of Title

OBJECTIVES

- List the essential elements of a valid deed and distinguish what is required for validity from what is required for recording.
- Compare the general warranty, special warranty, bargain and sale and quitclaim deeds, naming the five covenants of the general warranty deed.
- Match court-ordered and fiduciary deeds — sheriff's, referee's, executor's, administrator's, trustee's and reconveyance deeds — to the situations that produce them.
- Classify transfers as voluntary or involuntary alienation and apply the elements of adverse possession, including tacking.
- Use the vocabulary of probate — testate, intestate, devise, bequest, executor, administrator, heirs — and describe the special issues in probate sales.

> **Warm-up.** Your grandfather writes on a card, "I give my pocketknife to you," signs it, and puts it in his desk drawer. He never mentions it. Years later the card is found. Did he give you the knife? Write yes or no and one reason. You have just met the question of delivery — the element that decides more deed cases than any other.

WATCH

Types of Deeds You NEED to Know for the Real Estate Exam

Dee Kumar Real Estate · 9:35

https://www.youtube.com/watch?v=5q3B_5JjHeU

> **WHEN TO WATCH**
> Watch after the fourth core idea; as each deed appears, write it on a line from "most protection for the buyer" to "least," then check your line against the lesson.

BACKUP VIDEO

Adverse Possession, Quiet Title Action, Color of Title | Real Estate Exam Prep

The Real Estate Classroom · 12:38

https://www.youtube.com/watch?v=Hq5fO6i1udk

Watch with the sixth core idea; write the elements of adverse possession as he names them and add the tenant trap to your notebook.

KEY TERMS

deed

A written instrument by which an owner (grantor) conveys an interest in real property to another (grantee).

grantor and grantee

The grantor is the party conveying title, who must be legally competent and must sign; the grantee is the party receiving title, who must be identifiable but need not be competent.

granting clause and habendum clause

The granting clause contains the words of conveyance ("grant," "convey"); the habendum clause ("to have and to hold") defines the estate granted.

delivery and acceptance

The grantor's intentional, irrevocable transfer of the deed to the grantee during the grantor's lifetime, and the grantee's acceptance of it; title passes on delivery.

acknowledgment

A formal declaration before a notary or other authorized officer that the signature is genuine and voluntary; required for recording, not for validity.

general warranty deed

The deed giving the grantee the most protection, with covenants of seisin, quiet enjoyment, against encumbrances, further assurance and warranty forever, reaching back through the whole chain of title.

special warranty deed

A deed in which the grantor warrants only against defects arising during the grantor's own ownership ("by, through or under" the grantor).

bargain and sale deed

A deed that implies the grantor holds title and possession but makes no express warranties against encumbrances, unless covenants are added.

quitclaim deed

A deed that conveys whatever interest the grantor has, if any, with no warranties; commonly used to clear clouds on title.

voluntary and involuntary alienation

Voluntary alienation is a transfer the owner chooses (by deed or will); involuntary alienation is a transfer by operation of law or without consent (descent, foreclosure, eminent domain, escheat, adverse possession, partition, bankruptcy, natural forces).

adverse possession

Acquiring title to another's land by actual, open and notorious, continuous, hostile and exclusive possession for the period set by state statute.

testate and intestate

A person who dies with a valid will dies testate, and the estate passes by devise and bequest; one who dies without a will dies intestate, and the estate passes to heirs by the state's statute of descent.

CORE IDEAS

The story. For most of English history, land was not conveyed by paper at all. It passed by a ceremony called **livery of seisin**. The owner and the new owner walked onto the land itself, before neighbors as witnesses, and the owner handed over a clod of earth or a twig from a tree while speaking words of gift. The witnesses'

memories were the proof. In 1536, Parliament's Statute of Uses made it possible to pass title by a sale contract instead, and a companion Statute of Enrolments required such a "bargain and sale" of freehold land to be made by a written deed and enrolled in a public court — the origin of a deed name still used today. Finally, in 1845, the Real Property Act declared that freehold land should "be deemed to lie in grant as well as in livery": a deed alone could convey it. The turf and twig gave way to the signed and delivered deed — and the deed inherited the ceremony's two essentials: a clear intent to give, and an actual handing over.

How they figured it out. When a piece of paper replaced a public ceremony, the law had to decide what the paper must contain to be trusted. Over centuries courts and legislatures settled a short list of essentials, and American states adopted it. The deed must be **in writing**, because the Statute of Frauds (Lesson 7.1) requires transfers of land to be written. It must name a **competent grantor**, because only an owner with legal capacity can give, and an **identifiable grantee**, because a gift to no one is no gift. It must use **words of conveyance** and an **adequate legal description** so that everyone knows what passes. It must be **signed** by the grantor and actually **delivered** and accepted. Everything else — acknowledgment, recording, witnesses in some states — exists to prove the deed to strangers, the subject of Lesson 6.4.

The big idea. A valid deed requires: (1) a **writing**; (2) a **competent grantor** — of legal age and sound mind; (3) an **identifiable grantee** — a living person or existing legal entity, who need *not* be competent, since a child or a person under guardianship may receive land; (4) a **granting clause** with words of conveyance; (5) an **adequate legal description**; (6) a recital of **consideration** — often a nominal "ten dollars and other good and valuable consideration," or "love and affection" in a gift deed, which is good consideration; (7) the **signature of the grantor** (every grantor, or an attorney-in-fact under a power of attorney); and (8) **delivery and acceptance.** Title passes on **delivery**, which must occur while the grantor is alive and must be intended as final; a deed found in a dead man's drawer was never delivered. The **habendum clause** ("to have and to hold") defines the estate granted, such as a fee simple or a life estate. Two things are *not* required for validity: the grantee's signature, and **acknowledgment**, which is needed to *record* the deed.

Deeds differ mainly in the promises the grantor makes. The **general warranty deed** gives the most. Its five covenants: **seisin** (the grantor owns the estate and has the right to convey it); **quiet enjoyment** (no one with superior title will disturb the

grantee); **against encumbrances** (no liens or burdens except those stated); **further assurance** (the grantor will sign whatever else is needed to perfect title); and **warranty forever** (the grantor will defend title against all lawful claims, back through the whole chain of title, forever). A **special warranty deed** warrants only against defects that arose while the grantor owned the land — claims "by, through or under" the grantor — and is commonly used by corporations, trustees and lenders selling foreclosed property. A **bargain and sale deed** implies that the grantor holds title but makes no express warranty against encumbrances (a version "with covenant" adds a limited promise). A **quitclaim deed** promises nothing at all: it conveys whatever interest the grantor has, if any, and is the standard tool for clearing a **cloud on title** — say, from a former spouse or a distant heir.

Some deeds are named for who signs them. A **deed in trust** conveys land to a trustee; a **trustee's deed** conveys it out of a trust, including after a trustee's foreclosure sale; a **deed of reconveyance** returns title from the trustee to the borrower when a deed-of-trust loan is paid (Lesson 5.1). Court-ordered sales produce a **sheriff's deed** (after a judicial foreclosure or execution sale) or a **referee's deed** (from a court-appointed referee, as in a partition sale); such deeds carry no warranties beyond the officer's authority. An **executor's deed** or **administrator's deed** conveys property out of a deceased person's estate. Now step back: every transfer of title is either **voluntary alienation** — the owner chooses it, by deed during life or by will at death — or **involuntary alienation**, which happens by operation of law: descent to heirs when there is no will, foreclosure and tax sales, eminent domain, escheat to the state when there are no heirs, partition among co-owners, bankruptcy, adverse possession, and the natural forces of erosion and avulsion.

Adverse possession lets a possessor gain title to another's land by occupying it in a way that is **actual**, **open and notorious** (visible, as an owner would use it), **continuous** and uninterrupted, **hostile** (without the owner's permission — a tenant or a guest can never adversely possess), and **exclusive**, for the full period set by state statute, which varies by state and is often shorter with **color of title** (a defective deed) or payment of taxes. Successive possessors may add their periods together — **tacking** — if they are in privity, as when one sells or leaves the claim to the next. The title is not marketable until a court confirms it in a **suit to quiet title**. Government land generally cannot be adversely possessed. **Probate** handles transfers at death. One who dies with a will dies **testate**; the will's maker is the **testator**, a gift of real

property is a **devise** to a **devisee**, a gift of personal property is a **bequest** or **legacy** to a legatee, and the person the will names to carry it out is the **executor**. One who dies without a will dies **intestate**; the court appoints an **administrator**, and property passes by **descent** to heirs under the state statute — or escheats if there are none. Probate sales may need court confirmation, take longer and are usually as-is.

On the exam today. Expect the competence trap: the *grantor* must be competent; the *grantee* need only be identifiable. Expect "When does title pass?" — on *delivery* and acceptance, not on signing or recording. Expect "Acknowledgment is required for..." — recording, not validity. Expect "Which deed gives the buyer the greatest protection?" — general warranty; "the least?" — quitclaim; "warranty only during the grantor's ownership?" — special warranty. Expect covenant matching: seisin means the grantor owns it; further assurance means more paperwork will be signed if needed. Expect "A buyer at a foreclosure sale receives..." — a sheriff's deed (judicial) or trustee's deed (nonjudicial). Expect alienation sorting: a deed and a will are voluntary; escheat, condemnation and adverse possession are involuntary. Expect adverse-possession elements, the tenant trap (permission defeats hostility) and tacking. And expect probate vocabulary: devise is real property; bequest is personal property; an executor is named in a will, an administrator is appointed when there is none.

PICTURE STUDY



Reading the Will, Sir David Wilkie, 1820 · Oil on canvas · Neue Pinakothek, Munich

Image: Wikimedia Commons, public domain

Sir David Wilkie (1785–1841), the Scottish painter of everyday life, painted this scene in 1820 for King Maximilian I of Bavaria, which is why it hangs in Munich. A family has gathered after a death, and the lawyer reads the will aloud while every face shows what each relative hopes or fears: the widow in black, the woman holding up the heir, the latecomer in her fine clothes, the men craning to hear. This picture opens the lesson on transfer of title because it shows the moment when property passes by will — a devise or a bequest — and when the precise words of a written instrument suddenly matter to everyone in the room.

Look closely

- Find the lawyer and the large document in his hands. Every gift he reads is either a devise of land or a bequest of personal property — which kind would the house itself be?
- Look at the young widow in the armchair and the older woman holding up the baby. Who might be an heir, and who a devisee named in the will?
- Find the lady with the little dog coming through the door. Wilkie lets you guess whether she expects to be remembered in the will.

- Notice the trunk on the floor and the portrait on the wall. The person whose property is being divided is present only in a picture.

Talk about it

1. If this man had died without a will, who would have decided who received his house, and how?
2. Why must a will follow strict formalities — writing, signature, witnesses — when a family member might simply say what the dead man “wanted”?
3. Jeremiah sealed his deed and took witnesses so that no one could later dispute it. How does careful, honest paperwork become an act of love toward the family left behind?

PROJECT

Anatomy of a Recorded Deed

You will find a recorded deed from your own county — the deed to your family's home, with your parents' permission, or any deed available through the county recorder's free online index — and label every element on a printed or hand-copied version. You will then write a pretend deed of your own and build a chart of deed types. The labeled deed is one of the most useful pages in your Pathway File, because you will read hundreds of them in practice.

You will need

- A copy of a recorded deed (your family's, with permission, or one from the county recorder's online index)
- Highlighters in four colors
- This lesson's list of essential elements and the five covenants
- Paper for a pretend deed and a deed-type chart

Steps

1. Obtain a recorded deed. If you use a stranger's deed from the public index, copy only what the exercise needs and cover names and addresses in the version you file.
2. Highlight in one color the grantor, grantee and granting words; in a second, the legal description; in a third, the consideration and the habendum clause if present; in a fourth, the signature, acknowledgment and recording stamp.
3. Identify the deed type from its words ("warrants," "conveys and warrants," "quitclaims," "bargains and sells") and write which covenants, if any, it carries.
4. Answer in writing: which elements prove validity, and which exist for recording? Where is the evidence of delivery?
5. Write your own one-page pretend deed conveying a pretend lot from one pretend family to another, including all eight essential elements.
6. Make a deed-type chart ranking general warranty, special warranty, bargain and sale and quitclaim from most to least protection, adding sheriff's,

trustee's, executor's and reconveyance deeds with the situation that produces each.

7. Title the pages "Anatomy of a Deed," date them and file them in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the eight essentials of a valid deed, and a separate card listing the two things not required for validity (grantee's signature, acknowledgment).
2. Draw a protection ladder: general warranty at the top, then special warranty, bargain and sale, and quitclaim at the bottom; beside the top rung, write the five covenants.
3. Write a trap list titled "Words that sound alike": devise/bequest, devisee/legatee, executor/administrator, testate/intestate, grantor/grantee, acknowledgment/recording.

> **From history.** The habendum clause is a survivor from medieval Latin conveyancing, where deeds granted land *habendum et tenendum* — "to have and to hold" — to the grantee and his heirs. The phrase was so familiar to English ears that Archbishop Cranmer used it in the marriage service of the 1549 *Book of Common Prayer*: "to have and to hold from this day forward." A bride and groom who say those words before witnesses are using the oldest conveyancing language in English, describing a gift that is meant to be permanent.

Example 1. Mr. Abernathy signs and notarizes a deed giving his farm to his niece, names her clearly, describes the land by its legal description and recites "love and affection." He locks the deed in his safe, telling no one, and dies a year later. The niece finds it. Who owns the farm?

Show solution

1. Check the elements: writing — yes; competent grantor — yes; identifiable grantee — yes; words of conveyance and legal description — yes; consideration — "love and affection" is good consideration; signature — yes.
2. Check delivery: the grantor must intentionally and irrevocably hand over the deed during his life. Locking it in his own safe, telling no one, shows no intent to give up control.
3. Without delivery during his lifetime, no title passed; a deed cannot be delivered after the grantor's death.
4. The notarization (acknowledgment) does not help; it matters for recording, not validity.

Answer: The niece does not own the farm by this deed. It was never delivered, so the farm passes through the estate — by the will if he had one, or to his heirs by descent if he did not.

Example 2. Choose the deed most likely to be used in each case, and say why: (a) a buyer who wants the strongest possible promises from an individual seller; (b) a bank selling a house it took back in foreclosure; (c) a woman releasing any claim her ex-husband's name might cast on the title; (d) the buyer at a court-ordered judicial foreclosure sale.

Show solution

1. (a) General warranty deed — five covenants reaching back through the entire chain of title.
2. (b) Special warranty deed — the bank warrants only against problems arising during its own ownership, since it knows nothing of earlier owners.
3. (c) Quitclaim deed — the ex-husband conveys whatever interest he might have, with no warranties, clearing the cloud.
4. (d) Sheriff's deed — issued by the officer conducting the court-ordered sale, with no warranties beyond the officer's authority.

Answer: (a) General warranty; (b) special warranty; (c) quitclaim; (d) sheriff's deed.

Example 3. In this example, the state's adverse-possession period is 10 years. Ana fences and farms a strip of her neighbor's field openly, exclusively and without permission for 6 years, then sells her farm to Ben, describing the strip in the sale and handing over possession. Ben farms the strip the same way for 4 more years. The neighbor never objects. Can Ben claim the strip?

Show solution

1. Elements during each period: actual, open and notorious (fenced and farmed), continuous, hostile (no permission) and exclusive — all present.
2. Tacking: Ben may add Ana's 6 years to his 4 because he took possession from her by sale — they are in privity.
3. Total: $6 + 4 = 10$ years, meeting the statutory period.
4. To obtain marketable, insurable title, Ben must bring a suit to quiet title and have a court confirm his ownership.

Answer: Yes — by tacking his 4 years to Ana's 6, Ben meets the 10-year period in this example, but he needs a quiet title judgment before his title is marketable.

PRACTICE

1. Easy Who must be legally competent in a deed transaction — the grantor, the grantee, or both?

   Show answer

   The grantor. The grantee need only be identifiable and existing; a minor may receive title to land.

2. Easy At what moment does title pass by deed?

   Show answer

   On delivery and acceptance during the grantor's lifetime — not on signing, notarizing or recording.

3. Easy Name the five covenants of a general warranty deed.

   Show answer

   Seisin, quiet enjoyment, against encumbrances, further assurance, and warranty forever.

4. Medium Is a deed that was never acknowledged before a notary valid between grantor and grantee?

Show answer

Yes, if all the essential elements are present. Acknowledgment is needed to record the deed (and so give constructive notice), not to make it valid.

5. Medium What is the difference between a special warranty deed and a general warranty deed?

Show answer

A general warranty deed warrants title against defects from any time in the chain of title, forever. A special warranty deed warrants only against defects arising during the grantor's own ownership.

6. Medium Which is voluntary alienation and which involuntary: a will, escheat, eminent domain, a gift deed, a partition sale?

Show answer

Voluntary: the will and the gift deed. Involuntary: escheat, eminent domain and the partition sale, all of which occur by operation of law.

7. Medium A woman dies without a will and leaves two children. What is she called, who handles her estate, and how does her house pass?

Show answer

She died intestate. The court appoints an administrator, and the house passes by descent to her heirs under the state's statute of descent and distribution.

8. Hard A tenant farms land under a lease for 25 years, openly and continuously, and then claims ownership by adverse possession. Will the claim succeed?

Show answer

No. Possession under a lease is by the owner's permission, so it is not hostile. Without hostility, no period of possession, however long, ripens into title.

9. Hard A will says, “I leave my house on Elm Street to my son and my coin collection to my daughter.” Use the correct terms for each gift and each recipient.

Show answer

The house is a devise and the son a devisee (real property by will); the coin collection is a bequest or legacy and the daughter a legatee (personal property by will).

10. Hard A buyer’s title search shows that a man who divorced the seller years ago might still claim an interest. Which deed would clear the cloud, and why that deed?

Show answer

A quitclaim deed from the former husband. It conveys whatever interest he has, if any, without warranties — exactly what is needed to remove a possible claim without his promising anything about the title.

11. Challenge Explain why the law says a deed must be delivered during the grantor’s lifetime, but a will takes effect only at death. What would go wrong if a deed could be “delivered” after death?

Show answer

A deed is a present transfer; delivery shows a final intention to give up ownership now. A will is a different instrument with its own safeguards (witnesses, probate). If a deed could pass title after death without delivery, unsigned-for transfers would bypass the will’s formalities and the probate court, inviting fraud and disputes.

12. Challenge An executor is selling a house from an estate. Name four ways a probate sale may differ from an ordinary sale that the buyer’s agent should explain.

Show answer

The sale may require court approval or a confirmation hearing, sometimes with overbidding; it often takes longer; the property is usually sold as-is with limited seller knowledge or disclosures; and the deed is signed by the personal representative (an executor’s or administrator’s deed) rather than a living owner.

COMMON MISTAKES

- Requiring the grantee to be competent — only the grantor must be competent; the grantee must be identifiable.
- Saying title passes when the deed is signed or recorded — title passes on delivery and acceptance during the grantor's life.
- Calling acknowledgment a requirement for validity — it is required for recording.
- Thinking a quitclaim deed guarantees anything — it carries no warranties and conveys only whatever interest the grantor has.
- Treating a tenant or permitted user as an adverse possessor — permission destroys the element of hostility.
- Swapping devise and bequest — a devise is real property by will; a bequest or legacy is personal property.

Make it a game · Valid or Void?. A parent reads short deed stories: "signed by a 15-year-old grantor," "grantee is a 6-year-old girl," "never notarized," "found in the grantor's safe after death," "no legal description," "recites love and affection," "grantee never signed," "handed to the grantee at dinner." Players hold up VALID or VOID and name the element that decides it. Then switch to the deed-ladder round: the parent names a situation, and players call the deed type — general, special, quitclaim, sheriff's, trustee's or executor's. A point for each correct call; first to twelve wins and keeps the title "Master of the Rolls."

Scripture. "And I subscribed the evidence, and sealed it, and took witnesses, and weighed him the money in the balances." (Jeremiah 32:10, KJV)

When God told Jeremiah to buy his cousin's field during the siege of Jerusalem, the prophet did it with every formality: a written and signed deed, a seal, witnesses and payment by honest weight. The passage shows that careful legal form is not unspiritual — it is part of doing a transaction justly. It also shows hope: Jeremiah bought land because God promised that fields would again be bought and sold in the land.

UNIT 6 · LENDING LAW, TITLE AND CLOSING · LESSON 6.4 OF 50 · 3 SESSIONS OF 50 MINUTES

6.4 Recording, Title Search and Title Insurance

OBJECTIVES

- Distinguish actual from constructive notice and explain how recording and possession give notice to the world.
- Apply the race, notice and race-notice patterns of recording acts to decide who wins when an owner conveys the same land twice.
- Define chain of title, abstract of title, attorney's opinion of title, cloud on title and suit to quiet title, and tell marketable from insurable title.
- Compare owner's and lender's title policies and standard and extended coverage, and explain what title insurance does and does not protect against.
- Describe the Torrens system and the role of acknowledgment and the notary in making an instrument recordable.

> **Warm-up.** Imagine your town had no record office. A man offers to sell you a house and shows you a deed with his name on it. Write down three ways he could be cheating you that the deed alone would not reveal. Keep the list: by the end of the lesson you will know which tool — recording, a title search or title insurance — answers each one.

WATCH

Title Insurance | Real Estate Exam Prep

The Real Estate Classroom · 11:10

https://www.youtube.com/watch?v=P90TisXD5JA

> **WHEN TO WATCH**
> Watch after the fifth core idea; draw a two-by-two grid (owner's/lender's by standard/extended) and fill in who is protected and what is covered in each box.

BACKUP VIDEO

Real Estate Exam Prep | Transferring and Recording Title to Real Estate

Dee Kumar Real Estate · 7:50

https://www.youtube.com/watch?v=DTAxDB-ttVg

Watch with the third and fourth core ideas; note every kind of notice he mentions and label it actual or constructive.

recording

Entering a document affecting title in the public records of the county where the land lies, which gives constructive notice of it to the world.

actual notice

What a person actually knows, or has been told or has seen, about an interest in the property.

chain of title

The unbroken sequence of recorded conveyances by which title has passed from the original source to the present owner.

cloud on title

Any claim, document or encumbrance that may impair an owner's title, such as an unreleased mortgage or a possible heir's interest.

marketable title

Title free from reasonable doubt, which a reasonably prudent buyer would accept; insurable title is title a title company will insure, possibly with exceptions.

constructive notice

Notice the law presumes everyone has, whether or not they actually know, because the information is in the public records or could be learned by inspecting the property.

recording acts (race, notice, race-notice)

State statutes deciding priority between competing grantees: under race, first to record wins; under notice, a later buyer without notice wins; under race-notice, a later buyer wins only if without notice and first to record.

abstract of title

A condensed history of every recorded instrument affecting a parcel, prepared by an abstractor, which an attorney reviews to give an opinion of title.

suit to quiet title

A court action to remove a cloud and establish who owns the property, used for gaps in the chain, adverse-possession claims and disputed interests.

title insurance

A policy, bought with a one-time premium at closing, indemnifying the insured against loss from title defects that existed on the policy date and are not excepted.

owner's vs. lender's policy

An owner's policy protects the buyer for the purchase price as long as the buyer or heirs hold an interest; a lender's policy protects the lender for the loan balance and follows the loan when it is sold.

Torrens system

A land-registration system in which a court proceeding establishes title and a registrar issues a certificate of title that itself is the evidence of ownership.

CORE IDEAS

The story. In the 1860s a Philadelphia buyer named Watson hired a conveyancer, Muirhead, to search the title to a property before he bought it. Muirhead found a recorded judgment that might be a lien on the land, consulted a lawyer who told him the lien was not valid, and passed the title. The lawyer was wrong. The property was later sold at a sheriff's sale to satisfy the judgment, and Watson lost his investment. He sued the conveyancer — and lost again. In *Watson v. Muirhead* (1868), the Supreme Court of Pennsylvania held that a title searcher who acted with ordinary care and relied on a lawyer's opinion was not liable for an honest mistake. A buyer could do everything right and still be ruined. Pennsylvania's legislature responded in 1874 by authorizing companies to insure titles, and on March 28, 1876, a group of Philadelphia conveyancers organized the Real Estate Title Insurance Company of Philadelphia, commonly called the first title insurer of the modern kind. A buyer no longer had to prove anyone negligent; the insurer simply paid.

How they figured it out. Title insurance rests on an older American idea — public recording. On October 7, 1640, the General Court of the Massachusetts Bay Colony ordered that sales and mortgages of land be recorded, declaring that an unrecorded conveyance would not hold good against others, so that anyone could learn what interests others claimed in a parcel. Recording offices spread through the colonies and then to every county in the United States. Recording solved one problem — hidden prior deeds — but created another: to know a title was good, someone had to search a long, growing chain of records and judge every link. Some countries chose a different route. In 1858 Robert Torrens, a customs official in South Australia, persuaded its parliament to adopt **title registration**: a court would examine a title once, and the government would issue a certificate that *was* the title. Most American counties kept recording and searching, and let title insurance carry the risk of a mistake.

The big idea. The law gives notice two ways. **Actual notice** is what a person really knows — what he has read, been told or seen. **Constructive notice** is what the law presumes he knows whether he looked or not, because he *could* have learned it: everything properly **recorded** in the county records, and everything an inspection of the property would reveal. So a buyer is charged with notice of the rights of anyone **in possession** — a tenant with an unrecorded lease, a neighbor using a driveway — and must inspect, ask and search. To be recorded, a document must usually be **acknowledged** before a notary public or other authorized officer, who verifies the signer's identity and that the signature is voluntary. Recording does not make a deed valid between the parties (Lesson 6.3), but it protects the grantee against later claimants and fixes **priority**: as a rule, first in time is first in right, measured by the time of recording — except that property-tax liens and special assessments generally come first regardless of date.

When an owner dishonestly sells the same land twice, state **recording acts** decide who wins, and each state follows one of three patterns. In a **race** state, the first grantee to record wins, even if he knew of the earlier sale. In a **notice** state, a later buyer who paid value and had *no notice* of the earlier deed wins, even if the earlier deed is recorded later or never. In a **race-notice** state — the most common pattern — a later buyer wins only if he had no notice *and* recorded first. The protected person in every pattern is a **bona fide purchaser**: one who pays value in good faith without notice. The search for prior interests runs through the **chain of title**, the sequence of recorded conveyances from the original source to the present owner. A title examiner looks for gaps, unreleased mortgages, judgments, liens, easements and anything else that is a **cloud on title**. In some places an **abstractor** prepares an **abstract of title** — a summary of every recorded instrument — and an attorney reviews it and gives an **attorney's opinion of title**; elsewhere the title company searches and issues a commitment to insure.

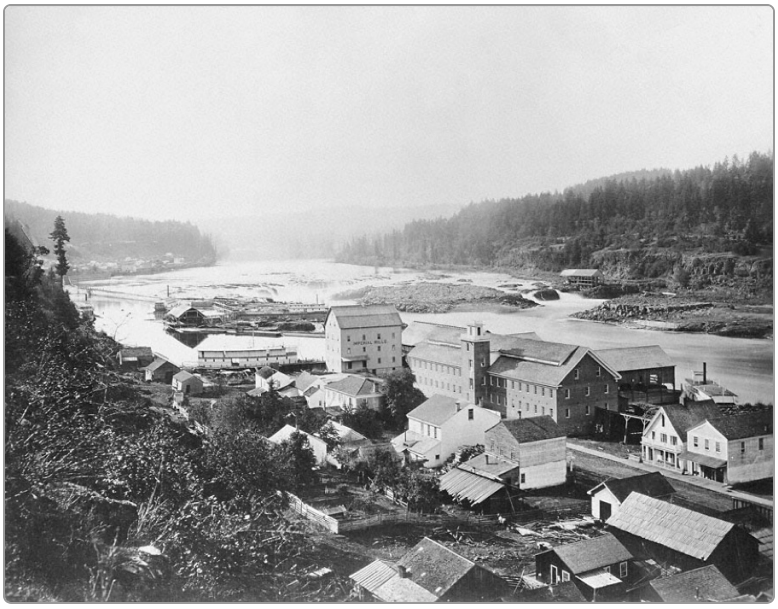
Two standards measure the result. **Marketable title** is title free from reasonable doubt — the kind a reasonably prudent buyer, advised by counsel, would accept; most purchase contracts require the seller to deliver it. **Insurable title** is title a title company will insure, sometimes with exceptions, which may be less than marketable. When a cloud cannot be cleared by a release or a quitclaim deed, the owner files a **suit to quiet title**, asking a court to declare who owns the land — the same suit an adverse possessor must bring before his title is marketable. **Title**

insurance then protects against loss from defects that existed *before* the policy date and were not excepted: forged deeds in the chain, deeds by incompetent grantors or minors, undisclosed heirs, recording errors, and liens the search missed. It is paid for with a **one-time premium** at closing, and unlike most insurance it looks backward — it does not cover problems that arise after the policy date.

There are two kinds of policy. An **owner's policy** protects the buyer, usually for the purchase price, for as long as the owner or the owner's heirs hold an interest; it is not assignable to a later buyer, who must buy his own. A **lender's (mortgagee's) policy** protects the lender, usually for the loan amount, decreasing as the loan is paid down, and it follows the loan if the loan is sold; lenders almost always require it, and it protects only the lender. Each comes in two levels. A **standard coverage** policy insures against defects in the public records and certain hidden risks such as forgery and incapacity, but excepts matters that only an inspection or survey would reveal. An **extended coverage** policy adds those off-record risks: unrecorded easements and liens, encroachments and boundary problems a survey would show, and rights of parties in possession. No policy covers zoning, defects the insured created or knew of and did not disclose, or later government action. Finally, the **Torrens system**: a court proceeding examines the title, a registrar issues a **certificate of title**, and that certificate is the conclusive evidence of ownership, with a state fund for anyone wrongly deprived; registered land generally cannot be taken by adverse possession. Only a few American jurisdictions still offer it.

On the exam today. Expect "Recording gives what kind of notice?" — constructive. Expect "A buyer who fails to inspect is still charged with notice of a tenant's rights" — possession gives constructive notice. Expect "Acknowledgment is required to…" — record. Expect priority questions: first to record generally wins, but property-tax liens come first. Expect recording-act patterns described, not named by state: in race-notice, the later buyer must be *both* without notice *and* first to record. Expect title vocabulary: abstract (summary), opinion of title (attorney's judgment), chain of title (sequence), cloud (claim), quiet title (lawsuit). Expect title insurance traps: it is paid *once*, protects against defects existing *before* the policy date, the owner's policy protects the owner while the lender's protects only the lender, and extended coverage adds what a survey and inspection would reveal. And expect "marketable" — free of reasonable doubt — versus "insurable."

PICTURE STUDY



Oregon City and Willamette Falls, Carleton E. Watkins, 1867 · Albumen photograph from a glass-plate negative · Oregon Historical Society (print); published from Watkins's negatives

Image: Wikimedia Commons, public domain

Carleton Watkins (1829–1916), famous for his mammoth-plate photographs of Yosemite, traveled up the Columbia and Willamette in 1867 and made this view of Oregon City. The town at the end of the Oregon Trail was the capital of Oregon's first government and the place where the territory's land titles began to be written down: in 1851 Oregon's first surveyor general opened his office here to start the rectangular survey, and in late 1854 the first federal land office in the territory opened, where settlers filed and proved their donation land claims. Every title search in the Willamette Valley eventually traces back to records first made in towns like this one.

Look closely

- Find the large mill buildings along the river. Industrial property like this was bought, mortgaged and leased — every transaction a link in a chain of title.
- Look at the small houses scattered up the slope. Each sat on a lot whose boundaries had to be described, recorded and searched before anyone could safely buy it.
- Follow the falls across the river. Water rights at Willamette Falls were valuable and disputed for decades — a reminder that title includes more than the ground itself.

- Notice the forested hills beyond the town. In 1867 much of that land was still in federal ownership, waiting for patents that would begin new chains of title.

Talk about it

1. If you were buying one of these mills in 1867, what records would you want to see, and where would you find them?
2. Why does a title search have to go back to the original government patent, and what could go wrong in between?
3. In Ruth 4, Boaz buys Naomi's land before the elders and all the people. Why does doing a land transfer in public protect the buyer, the seller and the neighbors?

PROJECT

Trace a Chain of Title

You will use your county recorder's or auditor's free online index to trace the recorded history of one parcel — your family's home with your parents' permission, or a public building such as a library, church or school — backward through at least five conveyances, and build a chain-of-title chart with every mortgage and release you find. Then you will mark any cloud or gap and say how it would be cured. The chart is the title page of your Pathway File.

You will need

- Your county recorder's, auditor's or clerk's online document index (many are free; some counties charge for copies)
- The parcel number from the county assessor's website
- Graph paper or a spreadsheet for the chain chart
- This lesson's key terms

Steps

1. Look up the parcel on the assessor's site to find the parcel number and the current owner's name (for a private home, use your own family's with permission).
2. In the recorder's index, find the most recent deed into the current owner and note its date, document type and instrument number.
3. Work backward: find the deed into that grantor, and the one before it, until you have at least five links. For each, record grantor, grantee, date, deed type and instrument number.
4. Search the same names for mortgages or deeds of trust recorded during each owner's time, and for the matching satisfactions or reconveyances. Mark any loan that seems never released.
5. Draw the chain as a ladder from oldest to newest, with loans hanging off each rung and releases closing them.
6. Write a short title report: is the chain unbroken? Are there clouds (unreleased liens, name changes, gaps)? For each, name the cure — release,

quitclaim, affidavit or suit to quiet title.

7. Title the page “Chain of Title,” date it and file it in your Pathway File. For a private home, file a copy with names reduced to initials.

EXAM NOTEBOOK

1. Make flashcards for actual notice, constructive notice, race, notice, race-notice, chain of title, abstract, opinion of title, cloud, quiet title, marketable and insurable title.
2. Draw a two-by-two grid — owner’s and lender’s policies across, standard and extended coverage down — and fill each box with who is protected and what is covered.
3. Write a trap list titled “Title insurance looks backward”: one-time premium, past defects only, owner’s policy not assignable, lender’s policy protects only the lender.

> **From history.** Robert Torrens took his idea from shipping. As a customs official in Adelaide, he had watched ships change hands by a simple entry in a public register of ships rather than by a chain of private documents, and he asked why land could not be handled the same way. His Real Property Act of 1858 made South Australia the first place to register land titles by government certificate. The system spread across Australia, New Zealand and parts of Canada, and several American states adopted it around 1900, though most later let it fade.

Example 1. On May 1, Owen sells his lot to Alice, who does not record her deed. On May 10, Owen sells the same lot to Ben, who pays full value and knows nothing of Alice's deed. On May 12, Alice records. On May 15, Ben records. Who owns the lot under a race statute, a notice statute and a race-notice statute?

Show solution

1. Race: the first to record wins, regardless of notice. Alice recorded on May 12, before Ben on May 15 — **Alice** wins.
2. Notice: a later bona fide purchaser without notice wins. When Ben bought on May 10, Alice's deed was unrecorded and he had no actual notice — **Ben** wins.
3. Race-notice: a later purchaser wins only if without notice *and* first to record. Ben had no notice but recorded after Alice — **Alice** wins.
4. The loser's remedy is against Owen, who sold the lot twice — which is why title insurance and prompt recording matter.

Answer: Race: Alice. Notice: Ben. Race-notice: Alice.

Example 2. The Lindqvists buy a home for $420,000 with a $336,000 loan. They buy a standard owner's policy; the lender requires a lender's policy. Two years later it is discovered that a deed in the chain of title 15 years ago was forged, and the true heir claims the house. Who is protected, and for how much?

Show solution

1. The forgery is a defect that existed before the policy date — exactly what title insurance covers, and forgery is covered even under standard coverage.
2. The owner's policy protects the Lindqvists, up to its face amount (commonly the $420,000 purchase price), by defending the title or paying their loss.
3. The lender's policy protects only the lender, up to the unpaid loan balance (somewhat under $336,000 after two years of payments).
4. Without the owner's policy, the lender would be protected while the family's down payment and equity were not.

Answer: Both are protected: the family by its owner's policy up to the purchase price, the lender by its policy up to the loan balance. The lender's policy alone would not have protected the family.

Example 3. Exam style. A buyer purchases a farm after a title search shows a clean record, and receives a standard-coverage owner's policy. After closing, a neighbor proves he has used a gravel lane across the farm openly for 25 years and holds a prescriptive easement never recorded. Is the buyer covered?

A. Yes — all title defects are covered

B. No — standard coverage excepts unrecorded matters an inspection would reveal

C. Yes — because the easement arose before the policy date

D. No — easements are never insurable

Show solution

1. The easement is an off-record matter: it appears in no public record but would be revealed by inspecting the land (a visible lane in use).
2. Standard coverage insures against defects in the public record (and certain hidden risks like forgery) but excepts rights that only an inspection or survey would disclose.
3. Extended coverage would have added off-record risks such as unrecorded easements and rights of parties in possession.
4. The buyer was also charged with constructive notice of the visible use — he should have inspected and asked.

Answer: B. Standard coverage excepts unrecorded easements and other matters an inspection would reveal; an extended-coverage policy would have been needed.

PRACTICE

1. Easy What kind of notice does recording a deed give?

Show answer

Constructive notice — the law presumes everyone knows what is properly recorded, whether or not they actually looked.

2. Easy What does a title insurance policy protect against, and how is it paid for?

Show answer

Loss from title defects that existed before the policy date and were not excepted, such as forgeries or missed liens. It is paid with a one-time premium at closing.

3. Easy What is a chain of title?

Show answer

The unbroken sequence of recorded conveyances by which title has passed from the original source, such as a government patent, to the present owner.

4. Medium A buyer never visits a rental house before buying it. A tenant there has an unrecorded five-year lease. Is the buyer bound by the lease?

Show answer

Yes. The tenant's possession gives constructive notice of the tenant's rights; a buyer is charged with what an inspection would have revealed, whether or not he inspected.

5. Medium What is the difference between an abstract of title and an attorney's opinion of title?

Show answer

The abstract is a condensed history of every recorded instrument affecting the parcel, prepared by an abstractor. The opinion of title is an attorney's professional judgment, after reviewing the abstract, about who owns the land and what encumbrances exist.

6. Medium Why does a buyer need an owner's title policy when the lender already requires a lender's policy?

Show answer

The lender's policy protects only the lender, up to the loan balance. Only an owner's policy protects the buyer's own investment — the down payment and growing equity.

7. Medium What does extended coverage add to a standard title policy?

Show answer

Protection against off-record risks that an inspection or survey would reveal: unrecorded easements and liens, encroachments and boundary problems, and rights of parties in possession.

8. Hard In a race-notice state, a seller deeds land to A, who delays recording. The seller then deeds it to B, who knows about A's deed. B records first. Who wins?

Show answer

A. Under race-notice, B must be both without notice and first to record. B recorded first but had actual notice of A's deed, so B is not protected.

9. Hard Title search shows the seller's name as "Katherine Smith" on the deed in and "Kate Smith-Jones" on the deed out, with no record explaining the change. What is the problem, and how might it be cured?

Show answer

A name discrepancy creates a possible gap or cloud in the chain of title. It can usually be cured by recording evidence of the name change (a marriage certificate or an affidavit of identity) or, if necessary, a corrective deed; the title company will require the cure before insuring.

10. Hard A homeowner sells after eight years. The buyer asks to take over the seller's owner's title policy. Can he?

Show answer

No. An owner's policy protects the insured owner (and heirs) and is not assignable to a new buyer, who must buy his own owner's policy. A lender's policy, by contrast, follows the loan when it is sold.

11. **Challenge** Compare the Torrens system with recording plus title insurance: who examines the title, what is the evidence of ownership, and who pays when a mistake is made?

    Show answer

    Under Torrens, a court examines the title once, and the registrar's certificate of title is itself conclusive evidence of ownership; a state assurance fund compensates anyone wrongly deprived. Under recording, a searcher examines the chain at each sale, the recorded deeds are evidence of title, and a title insurer pays for covered mistakes under its policy.

12. **Challenge** Explain why *Watson v. Muirhead* led to title insurance rather than to stricter liability for title searchers.

    Show answer

    The court held that a searcher who used ordinary care was not liable for an honest error, so buyers could be ruined without anyone at fault. Instead of making searchers guarantors, Pennsylvania authorized companies to insure titles, pooling the risk of hidden defects across many buyers for a one-time premium, so that a loss would be paid without proving negligence.

COMMON MISTAKES

- Thinking recording makes a deed valid — a deed is valid on delivery; recording gives constructive notice and protects priority.
- Believing a buyer who never inspected is free of a tenant's unrecorded lease — possession gives constructive notice.
- Treating title insurance like other insurance with annual premiums covering future events — it is a one-time premium covering past defects.
- Assuming the lender's policy protects the buyer — it protects only the lender; the buyer needs an owner's policy.
- Confusing marketable title (free of reasonable doubt) with insurable title (a company will insure it, possibly with exceptions).
- Forgetting that property-tax liens and special assessments generally take priority over earlier-recorded liens.

Make it a game · Who Wins the Lot?. Write three cards: RACE, NOTICE and RACE-NOTICE. A parent tells a double-sale story — who bought first, who recorded first, who knew what — and draws one card. Players race to name the winner under that pattern and explain in one sentence. Then play the policy round: the parent names a problem (forged deed in the chain, a neighbor's unrecorded lane, a new zoning rule, a missed tax lien, a lien the buyer created after closing) and players call COVERED, EXTENDED ONLY or NOT COVERED. One point per correct answer; first to ten wins.

Scripture. "And Boaz said unto the elders, and unto all the people, Ye are witnesses this day, that I have bought all that was Elimelech's, and all that was Chilion's and Mahlon's, of the hand of Naomi." (Ruth 4:9, KJV)

Boaz did not buy Naomi's land in secret. He sat at the city gate, called the elders and the people as witnesses and declared the transfer aloud, so that no one could later dispute it. Public recording does the same work today: it turns a private agreement into a fact the whole community can know and rely on, protecting the buyer, the seller and every neighbor.

6.5 The Closing: Prorations, Debits and Credits

OBJECTIVES

- Name the parties to a closing and compare an escrow closing with a table (roundtable) closing.
- Prorate property taxes paid in arrears and in advance, rent and association dues, using both the 365-day year and the 360-day statutory year.
- Decide whether each closing item is a debit or a credit to the buyer, the seller or both, using the rule that a debit is what a party owes and a credit is what a party receives.
- Compute a seller's net proceeds and a buyer's cash to close from a list of closing items.
- Explain transfer taxes, recording fees, home and new-construction warranties and 1099-S reporting at a level the exam expects.

> **Warm-up.** You and a friend split a $30 pizza, but you leave after eating only a third of it — and you paid the whole bill. How much should your friend pay you back? Write the answer and the arithmetic. You have just prorated an expense and recorded a debit and a credit, which is exactly what a closing agent does with a year's property taxes.

WATCH

Credits And Debits Explained For Real Estate Exam | Intro To The Dam/Dams Method To Proration

Just Call Maggie · 13:27

https://www.youtube.com/watch?v=LL47mnmEkdI

> **WHEN TO WATCH**
> Watch after the fourth core idea; pause at each practice question, write your debit/credit answer and your arithmetic, then compare with hers — and note which day-of-closing convention each problem uses.

BACKUP VIDEO

Real Estate Prorations Made Easy - Step-by-Step Exam Prep

Caffeinated Math Teacher · 3:51

https://www.youtube.com/watch?v=ISphEXqCLGc

A four-minute proration drill; watch before practice problems 4 and 11 and work her example on paper before she does.

KEY TERMS

closing (settlement)

The completion of a sale, when the deed is delivered, the purchase price and loan funds are paid out, and the documents are recorded.

escrow agent (closing agent)

A neutral third party who holds documents and funds, follows the parties' written instructions and disburses money when every condition is met.

escrow closing vs. table closing

In an escrow closing the parties deliver documents and funds to the escrow agent separately and need not meet; in a table (roundtable) closing all parties meet to sign and exchange documents and funds.

proration

The division of an expense or income item between buyer and seller in proportion to the time each owns the property during the period.

taxes paid in arrears vs. in advance

Taxes paid in arrears are paid after the period they cover, so the seller credits the buyer for the seller's unpaid share; taxes paid in advance were prepaid by the seller, so the buyer credits the seller for the buyer's share.

statutory (banker's) year

A 360-day year of twelve 30-day months used in some proration problems and customs, as opposed to the actual 365-day year.

debit

An amount a party owes or must pay at closing, charged against that party on the closing statement.

credit

An amount a party receives or is given credit for at closing, reducing what the party owes or increasing what the party receives.

net to seller

The cash the seller receives at closing: the total of the seller's credits minus the total of the seller's debits.

cash to close

The amount the buyer must bring to closing: the total of the buyer's debits minus the total of the buyer's credits.

transfer tax

A state or local tax on the transfer of real property, commonly figured on the sale price and paid by the party local law or custom designates.

Form 1099-S

The federal information return on which the settlement agent reports the seller's gross proceeds from a real estate sale to the Internal Revenue Service.

CORE IDEAS

The story. In the small hours of March 30, 1867, in the State Department in Washington, Secretary of State William Seward and the Russian minister, Baron Eduard de Stoeckl, signed a treaty by which Russia sold Alaska to the United States for $7.2 million. The Senate approved it ten days later. On October 18, 1867, at Sitka, Russian soldiers lowered their flag, American soldiers raised theirs, and the land and its government passed to the United States — the day Alaskans still celebrate as Alaska Day. But the money had not been paid. The House of Representatives did not vote the appropriation until July 1868, and only on August 1, 1868 did the Treasury issue its warrant for $7,200,000 to the Russian minister. For more than nine months,

one side had delivered and the other had not yet paid. Two great nations could trust each other's word that long. Ordinary buyers and sellers cannot, and the modern closing exists so that neither has to.

How they figured it out. The answer is a neutral middle party and a single moment. In a modern sale, the seller's deed and the buyer's money both go to a closing agent — an **escrow agent**, a title company's closing officer or a closing attorney, depending on local custom — who holds them under written instructions until every condition is met: the loan is funded, the title is clear and insured, the documents are signed. Then, in one coordinated step, the deed is delivered and recorded, the seller's loan is paid off, and the money is distributed. To make the books balance, closing agents developed the **closing statement**: a ledger listing everything each party owes (**debits**) and everything each party receives (**credits**), including **prorations** that divide taxes, rents and dues fairly between the old owner and the new. Since 2015 the buyer's figures appear on the Closing Disclosure (Lesson 6.2); many settlement agents also prepare a combined statement for both sides.

The big idea. A closing brings together the buyer and seller, their real estate licensees, the buyer's lender, the title company and the closing agent. Before it, the buyer has the title commitment reviewed, completes inspections, obtains homeowners insurance, receives the Closing Disclosure three business days ahead, and makes a final walk-through; the seller orders payoff statements for existing loans and clears title requirements. Customs differ by region. In an **escrow closing**, common in the western states including the Northwest, each party signs separately with the escrow agent and the parties may never meet. In a **table (roundtable) closing**, common in much of the East, everyone gathers around one table to sign and exchange. Either way, the money arrives in recognizable pieces: the buyer's **earnest money** deposited when the contract was signed, the **loan** funds from the lender, and the buyer's remaining **down payment** and closing costs, brought as "cash to close." The arithmetic rule for every item is simple: a **debit** is what a party owes; a **credit** is what a party receives or gets credit for.

Prorations divide ongoing expenses and income in proportion to ownership. First decide who owns the **day of closing**: commonly the seller is charged through the day of closing, but some areas and some exam problems give that day to the buyer — every problem will say, and you must use what it says. Second, choose the year: the actual **365-day year** (daily rate = annual amount ÷ 365, counting actual days), or the

360-day statutory year of twelve 30-day months (monthly rate = annual ÷ 12, daily rate = monthly ÷ 30). Third, ask whether the item was paid in **arrears** or in **advance**. Property taxes in many places are paid in arrears — after the period. Then the seller has used the property for part of the year but not paid for it, so the seller's share is a *debit to the seller and a credit to the buyer*, who will pay the whole bill later. If the seller prepaid the year's taxes, the buyer's share of the remaining year is a *debit to the buyer and a credit to the seller*. Rent works the same way: a seller who collected a full month's rent in advance owes the buyer the days after closing — debit seller, credit buyer — and tenants' security deposits pass to the buyer as a debit to the seller and a credit to the buyer. Association dues paid in advance are credited back to the seller.

A clean way to sort the closing statement is to ask whether an item moves money *between* buyer and seller or only between one of them and an outsider. **Double entries** appear on both sides, once as a debit and once as a credit: the purchase price (debit buyer, credit seller), every proration, and any seller credit toward the buyer's costs. **Single entries** appear on one side only: the new loan and the earnest money are credits to the buyer; the buyer's loan costs and prepaid items are debits to the buyer; the seller's loan payoff, the commission the seller agreed to pay, and the seller's share of title and transfer charges are debits to the seller. The **net to seller** is the seller's credits minus the seller's debits; the buyer's **cash to close** is the buyer's debits minus the buyer's credits. In this example, a $400,000 sale with a $20,000 commission (5%, negotiated), a $212,500 payoff, $6,700 of seller title, transfer-tax and escrow charges and a $1,660 tax proration nets the seller $159,140. Commissions are always negotiable between broker and client, and who pays which charges is set by the contract and local custom.

A few more items complete the exam's list. A **transfer tax** (called an excise or documentary stamp tax in some states) is levied by many states and localities on the sale price; who pays it is set by law or custom and is usually the seller. **Recording fees** are charged by the county to record documents: the buyer customarily pays to record the deed and the new mortgage or deed of trust, the seller to record the release of the old loan. A **home warranty** is a service contract covering repair of major systems and appliances for a year or so, often bought by the seller as a marketing feature; a **new-construction warranty** is the builder's promise to repair defects in workmanship and materials for stated periods, and may be backed by a third-party warranty company. Finally, federal tax law requires the settlement agent

to report most sales to the IRS on **Form 1099-S**, showing the seller's gross proceeds. After closing, the agent records the documents, pays off the old loan, disburses the funds and sends the seller and buyer their final statements.

On the exam today. Expect a tax proration: read the problem for the closing date, who owns the day of closing, 360 or 365 days, and arrears or advance — then compute the seller's days, multiply by the daily rate, and pick the right debit-credit direction. The classic trap: taxes paid in arrears are a *debit to the seller, credit to the buyer*; prepaid taxes are the reverse. Expect a rent proration: rent collected in advance means debit seller, credit buyer for the buyer's days. Expect "Which is a credit to the buyer only?" — the new loan or the earnest money. Expect "Which is a debit to the seller only?" — the loan payoff or the commission. Expect "The purchase price is entered as..." — a debit to the buyer and a credit to the seller. Expect a seller's net or buyer's cash-to-close computation. And expect concept questions: an escrow agent is a neutral party bound by written instructions; the settlement agent files the 1099-S; earnest money is credited to the buyer.

PICTURE STUDY



View of Sitka from the Governor's Garden, Eadweard Muybridge, 1868 · Black-and-white photograph from a glass-plate negative · Reproduced from a historic print of Muybridge's 1868 Alaska series

Image: Wikimedia Commons, public domain

Eadweard Muybridge (1830–1904), later famous for his photographs of horses in motion, sailed to Alaska in 1868 to photograph the new American territory for the government. In Sitka he made this view of the town a few months after the Russian flag had come down there in October 1867 — and in the very summer that the Treasury finally paid for the purchase. The Russian cathedral of St. Michael still stands on the left, and the houses below had just passed from Russian to American hands. This picture opens the lesson on the closing because it shows property that had already been delivered while the price was still unpaid — the gap a modern escrow closing is designed to close.

Look closely

- Find St. Michael's Cathedral with its onion dome. The buildings stayed where they were; only the title to the land beneath them changed.
- Look at the small wooden houses along the shore. Each would one day need its own deed, survey and recorded chain of title under American law.
- Follow the bay to the mountain behind the town. What did the United States actually receive at the October 1867 ceremony — and what had it not yet paid?

- Notice the steep roof in the foreground. Muybridge stood on high ground to show the whole town at once, as a closing statement shows the whole transaction on one page.

Talk about it

1. Russia delivered Alaska in October 1867, but payment came in August 1868. In a home sale, what protects a seller from delivering a deed and never being paid?
2. Which items on a modern closing statement — prorations, payoffs, recording fees — would have had a parallel in the transfer of a whole territory, and which would not?
3. Abraham weighed out the silver “current money with the merchant” in front of witnesses. What does paying exactly, openly and in full say about a buyer’s character?

PROJECT

Close the Pretend Sale

You will act as the closing agent for a pretend sale and build a complete two-column settlement statement — buyer's debits and credits, seller's debits and credits — with every proration worked out in a margin, then compute the seller's net and the buyer's cash to close and prove that the books balance. If your family is willing, you will also compare your statement with a real Closing Disclosure from a past purchase, with private numbers covered. The statement is the final page of your Pathway File's closing section.

You will need

- Columnar paper or a spreadsheet with four money columns
- Your Lesson 5.2 Loan Calculator Sheet
- A calendar for counting days
- Optionally, a real Closing Disclosure or settlement statement from your family's files, with permission

Steps

1. Invent the sale: a pretend house, price, earnest money, new loan amount, the seller's payoff, an example commission rate, a closing date and the day-of-closing convention you will use.
2. Add three prorations: property taxes (choose arrears or advance), monthly association dues paid in advance, and — if the house is rented — rent and the security deposit. Show each calculation in the margin with both the 365-day and the 360-day method.
3. Add single-entry items: buyer's loan costs and prepaid items, seller's payoff, commission, title policy, an example transfer tax and recording fees, each marked "example."
4. Enter every item in the correct column(s): debit buyer, credit buyer, debit seller, credit seller.
5. Total each column; compute net to seller and cash to close; prove the balance — the buyer's cash plus the loan should cover the price and the buyer's costs, and the seller's net plus the seller's debits should equal the seller's credits.

6. If you have a real Closing Disclosure, find the matching lines on its pages 2 and 3 and note any item your pretend statement missed.
7. Title the page “Settlement Statement,” date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every common closing item — front: the item; back: debit or credit, to whom, and whether it is a double or single entry.
2. Draw the four-column settlement grid (Buyer Debit, Buyer Credit, Seller Debit, Seller Credit) and fill in the price, earnest money, new loan, payoff, commission, taxes in arrears and rent collected in advance.
3. Write a trap list titled “Arrears vs. advance”: arrears — seller owes buyer (debit seller, credit buyer); advance — buyer owes seller (debit buyer, credit seller).

KEY FORMULAS

$$\text{Daily rate (365-day year)} = \frac{\text{Annual amount}}{365}$$

$$\text{Daily rate (360-day year)} = \frac{\text{Annual amount}}{12} \div 30$$

$$\text{Proration} = \text{Daily rate} \times \text{Days owned by the party who owes}$$

$$\text{Net to seller} = \text{Seller's credits} - \text{Seller's debits}$$

$$\text{Cash to close} = \text{Buyer's debits} - \text{Buyer's credits}$$

From history. The word escrow comes from the Old French *escroe*, a scroll or strip of parchment. In English law a deed “delivered in escrow” was handed to a third person to be passed to the grantee only when a stated condition was met — the same idea a modern escrow agent carries out with wire transfers and electronic recording. The western states, including Washington and Oregon, built a whole profession of licensed or regulated escrow agents around that medieval practice.

Example 1. In this example, annual property taxes are $3,650, the year runs January 1–December 31, closing is June 15 (not a leap year), and the seller is charged through the day of closing using a 365-day year. Prorate the taxes (a) if they are paid in arrears and unpaid at closing, and (b) if the seller already paid the full year in advance.

Show solution

1. Daily rate: $\$3{,}650 \div 365 = \$10.00$ per day.
2. Seller's days, January 1 through June 15: $31 + 28 + 31 + 30 + 31 + 15 = 166$ days. Buyer's days: $365 - 166 = 199$.
3. (a) Arrears: the seller has not paid for the 166 days he owned it, and the buyer will pay the whole bill later. $166 \times \$10 = \$1{,}660$ — debit the seller, credit the buyer.
4. (b) Advance: the seller paid for days the buyer will own. $199 \times \$10 = \$1{,}990$ — debit the buyer, credit the seller.

Answer: (a) $1,660 debit seller, credit buyer. (b) $1,990 debit buyer, credit seller.

Example 2. A seller owns a rented house. The tenant paid June's rent of $1,800 to the seller on June 1, and the seller holds a $1,800 security deposit. Closing is June 15; the seller owns the day of closing; use the actual 30 days of June. Prorate the rent and handle the deposit. Then, separately, prorate annual taxes of $4,320, paid in arrears, for an April 20 closing using a 360-day year, the seller owning the day of closing.

Show solution

1. Rent daily rate: $\$1{,}800 \div 30 = \$60$. Buyer's days, June 16–30: 15. Buyer's share: $15 \times \$60 = \$900$ — debit seller, credit buyer, since the seller collected it.
2. Security deposit: the buyer takes over the duty to return it, so $1,800 is a debit to the seller and a credit to the buyer.
3. Taxes, 360-day year: monthly $\$4{,}320 \div 12 = \$360$; daily $\$360 \div 30 = \$12$.
4. Seller's time: January–March is 3 months, plus 20 days in April: $3 \times \$360 + 20 \times \$12 = \$1{,}080 + \$240 = \$1{,}320$ — arrears, so debit seller, credit buyer.

Answer: Rent: $900 and deposit $1,800, each debit seller, credit buyer. Taxes: $1,320 debit seller, credit buyer.

Example 3. In this example, a home sells for $400,000. Seller items: commission 5% (negotiated); loan payoff $212,500; owner's title policy $1,800; transfer tax at an example 1% rate; half the escrow fee and the release recording, $900; and the tax proration of $1,660 from the first example. Buyer items: earnest money $10,000; new loan $320,000; buyer's loan costs and prepaid items $7,500. Find the net to seller and the buyer's cash to close.

Show solution

1. Seller credits: the price, $400,000.
2. Seller debits: $\$20{,}000 + \$212{,}500 + \$1{,}800 + \$4{,}000 + \$900 + \$1{,}660 = \$240{,}860$.
3. Net to seller: $\$400{,}000 - \$240{,}860 = \$159{,}140$.
4. Buyer debits: $\$400{,}000 + \$7{,}500 = \$407{,}500$. Buyer credits: $\$10{,}000 + \$320{,}000 + \$1{,}660 = \$331{,}660$.
5. Cash to close: $\$407{,}500 - \$331{,}660 = \$75{,}840$.

Answer: Net to seller $159,140; buyer's cash to close $75,840. Note the tax proration appears twice — a debit to the seller and a credit to the buyer.

PRACTICE

1. Easy How is the purchase price entered on a closing statement?

   Show answer

   As a debit to the buyer (who owes it) and a credit to the seller (who receives it) — a double entry.

2. Easy Is the buyer's earnest money a debit or a credit, and to whom?

   Show answer

   A credit to the buyer only. The buyer already paid it, so it reduces what the buyer must bring to closing; it does not appear on the seller's side as a separate entry.

3. **Easy** What is the difference between an escrow closing and a table closing?

Show answer

In an escrow closing, the parties deliver documents and money separately to a neutral escrow agent and need not meet. In a table (roundtable) closing, all parties meet together to sign and exchange documents and funds.

4. **Medium** Annual taxes of $2,920 are paid in arrears. Closing is March 31, and the seller owns the day of closing (365-day year, not a leap year). Prorate the taxes.

Show answer

Daily rate $\$2{,}920 \div 365 = \$8$. Seller's days: $31 + 28 + 31 = 90$. Proration $90 \times \$8 = \$720$ — debit seller, credit buyer.

5. **Medium** The seller prepaid annual association dues of $1,200 for the calendar year. Closing is September 30, seller owning that day, using a 360-day year. Prorate the dues.

Show answer

Monthly $\$1{,}200 \div 12 = \$100$. The buyer owns October through December, 3 months: $300 — debit buyer, credit seller, because the seller prepaid them.

6. **Medium** Which of these is a debit to the seller only: the purchase price, the seller's loan payoff, the buyer's new loan, or taxes paid in arrears?

Show answer

The seller's loan payoff. The price and the tax proration are double entries; the new loan is a credit to the buyer only.

7. **Medium** The seller collected $2,100 rent for May on May 1. Closing is May 20 and the buyer owns the day of closing. Using 31 days, how is the rent prorated?

Show answer

Daily rate $\$2{,}100 \div 31 \approx \$67.74$. Buyer owns May 20–31, 12 days: $12 \times \$67.74 \approx \$812.90$ — debit seller, credit buyer.

8. Hard In this example, a seller's credits total $365,000 (the price). Debits: 6% commission (negotiated), payoff $148,300, title and escrow $2,450, tax proration $1,210. Find the net to seller.

Show answer

Commission $0.06 \times \$365{,}000 = \$21{,}900$. Debits $\$21{,}900 + \$148{,}300 + \$2{,}450 + \$1{,}210 = \$173{,}860$. Net $\$365{,}000 - \$173{,}860 = \$191{,}140$.

9. Hard A buyer's debits are the $310,000 price and $6,200 of loan costs and prepaid items. Credits are $5,000 earnest money, a $279,000 loan, a $940 tax proration and a $1,500 seller credit for repairs. What is the cash to close?

Show answer

Debits $\$316{,}200$; credits $\$5{,}000 + \$279{,}000 + \$940 + \$1{,}500 = \$286{,}440$; cash to close $\$316{,}200 - \$286{,}440 = \$29{,}760$.

10. Hard Explain why a tax proration for taxes paid in arrears is a debit to the seller even though the seller writes no check to the county at closing.

Show answer

The seller used the property for part of the tax year but has not paid for it, while the buyer will pay the whole year's bill when it comes due. The debit to the seller and credit to the buyer moves the seller's share to the buyer at closing, so each pays only for the days he owned the property.

11. Challenge Annual taxes of $5,400 are paid in arrears; closing is August 10; the seller owns the day of closing. Compute the proration with a 360-day year and with a 365-day year (not a leap year), and state the difference.

Show answer

360-day: monthly $450, daily $15; seller has 7 months and 10 days: $7 \times \$450 + 10 \times \$15 = \$3{,}300$. 365-day: daily $\$5{,}400 \div 365 \approx \$14.795$; seller's days $212 + 10 = 222$; $222 \times \$14.795 \approx \$3{,}284.38$. The 360-day method gives about $15.62 more; both are debit seller, credit buyer.

12. **Challenge** Using the Alaska purchase as a contrast, explain three ways an escrow closing protects both buyer and seller from the risk that one performs and the other does not.

Show answer

The escrow agent holds the seller's deed until the buyer's full funds (and the lender's) are on hand, so the seller never gives title without payment. It holds the buyer's money until title is clear, insured and ready to record, so the buyer never pays without receiving title. And it disburses everything at once under written instructions, recording the deed and paying off liens in a single coordinated step, so neither party must trust the other's promise across months, as the nations did in 1867–1868.

COMMON MISTAKES

- Reversing the tax proration — taxes paid in arrears are a debit to the seller and credit to the buyer; prepaid taxes are a debit to the buyer and credit to the seller.
- Ignoring the day-of-closing convention — the seller is commonly charged through the day of closing, but read each problem; some give that day to the buyer.
- Entering the new loan or earnest money on the seller's side — both are credits to the buyer only.
- Treating the seller's loan payoff as a double entry — it is a debit to the seller only, paid to the seller's lender.
- Using 365 days when the problem specifies a 360-day statutory year, or vice versa — the answers differ, and the exam's choices include both.
- Stating that commissions are a fixed percentage — every commission is negotiated between the broker and the client.

> **Make it a game · The Proration Race.** Each player draws a four-column grid (Buyer Debit, Buyer Credit, Seller Debit, Seller Credit). A parent rolls two dice for the closing month (add them; 2–12 is February through December) and one die for a day of the month (multiply by 5). Annual taxes are $3,600, paid in arrears, on a 360-day year with the seller owning the day of closing. Players race to compute the seller's share and write it in the correct two columns. First correct answer scores two points; correct columns score one more. Every third round, switch to "paid in advance" and watch for reversed columns.

> **Scripture.** “And Abraham hearkened unto Ephron; and Abraham weighed to Ephron the silver, which he had named in the audience of the sons of Heth, four hundred shekels of silver, current money with the merchant.” (Genesis 23:16, KJV)
>
> Abraham’s purchase of the field and cave of Machpelah is the Bible’s first recorded land closing: the price was named publicly, the silver was weighed out in full “current money,” and the witnesses at the city gate saw the field “made sure” to him. A modern settlement statement does the same work with columns instead of scales — every amount stated openly, paid exactly, and witnessed by the record.

UNIT 6

Lending Law, Title and Closing

A house changes hands in a single afternoon, but behind that afternoon stand five centuries of law. In this unit you will learn the federal rules that make a home loan honest — the **Truth in Lending Act** with its annual percentage rate, advertising triggers and three-day **right of rescission**; the **Equal Credit Opportunity Act**; and **RESPA**, which forbids kickbacks and, joined with Truth in Lending in the **TRID** rule, gives every borrower a Loan Estimate and a Closing Disclosure on a strict clock of business days. Then you will learn how ownership itself moves: the essential elements of a valid **deed**, the promises of the general warranty deed and the silence of the quitclaim, the involuntary transfers from escheat to **adverse possession**, and the vocabulary of wills and probate.

The last two lessons follow the deed to the county record office and the closing table. You will see why **recording** gives notice to the world, how a title examiner reads a chain of title, and why buyers insure their titles after a Philadelphia buyer lost everything in 1868 through no one's fault. Finally you will sit in the closing agent's chair and work the arithmetic of **prorations**, **debits and credits**, the seller's net and the buyer's cash to close. The stories run from an English ceremony of turf and twig to the purchase of Alaska; the scriptures run from Abraham weighing silver at Hebron to Jeremiah sealing his deed before witnesses. Count business days carefully, keep your calendar beside your calculator, and treat every fee and rate as an example.

PREREQUISITES

- Can explain the note, the mortgage and the deed of trust and the parties to each, from Lesson 5.1
- Can compute one month's interest, points, LTV and PITI with the Loan Calculator Sheet from Lesson 5.2
- Can state the elements of a legal description and the meaning of legal and equitable title, from Units 1 and 2
- Has a printed calendar and a basic calculator ready, and the exam notebook current through Unit 5

MASTERY CHECKLIST

- ☐ I can distinguish the APR from the note rate, identify advertising triggering terms and the required disclosures, and decide whether a loan carries a right of rescission.
- ☐ I can list ECOA's protected bases, describe the adverse-action notice, and recognize predatory lending and mortgage fraud.
- ☐ I can apply RESPA Section 8 and the affiliated business arrangement rules to referral scenarios, and state the escrow cushion limit.
- ☐ I can count the TRID deadlines for the Loan Estimate and Closing Disclosure, name the three changes that restart the wait, and compute a tolerance cure.
- ☐ I can list the essential elements of a valid deed, rank the deed types by protection, and name the five covenants of a general warranty deed.
- ☐ I can classify voluntary and involuntary alienation, apply the elements of adverse possession with tacking, and use the vocabulary of probate correctly.
- ☐ I can decide priority under race, notice and race-notice recording acts and compare owner's, lender's, standard and extended title policies.
- ☐ I can prorate taxes, rent and dues by the 365-day and 360-day

methods, place each closing item in the right debit or credit column, and compute net to seller and cash to close.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **CFPB: Your Home Loan Toolkit**: Free, official. The booklet lenders must give every applicant for a home-purchase loan, with worksheets on choosing a loan and reading the Loan Estimate and Closing Disclosure. Read it with Lessons 6.2 and 6.5. Ages 15 and up.
- **CFPB: Loan Estimate Explainer**: Free, official. An interactive, page-by-page walk through a sample Loan Estimate, with downloadable sample forms for fixed and adjustable loans. Use it for Lesson 6.2's project. Ages 15 and up.
- **CFPB: Closing Disclosure Explainer**: Free, official. The companion walk-through of the five-page Closing Disclosure, line by line. Use it with Lesson 6.5 to match your pretend settlement statement to the real form. Ages 15 and up.
- **CFPB: Interactive Regulation Z**: Free, official. The full text of Regulation Z with the CFPB's official interpretations, searchable by section — the advertising rules (1026.24), rescission (1026.23) and TRID timing (1026.19). Use it in Lessons 6.1 and 6.2 to check any rule at its source. Ages 16 and up.
- **CFPB: TILA-RESPA Integrated Disclosure Resources**: Free, official. The CFPB's compliance page for TRID, with its small-entity compliance guide and timeline charts written for lenders and settlement agents. Skim the timing and tolerance sections after Lesson 6.2. Ages 16 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

6.1	**Truth in Lending and the Fair Lender**	3 sessions of 50 minutes
6.2	**RESPA, TRID and the Closing Disclosures**	3 sessions of 50 minutes
6.3	**Deeds and the Transfer of Title**	3 sessions of 50 minutes
6.4	**Recording, Title Search and Title Insurance**	3 sessions of 50 minutes

Unit 6 test

Closed book, closed notebook, basic calculator only; a blank calendar page is allowed. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Choose the one BEST answer. Figures marked “in this example” are examples: real fees, tax rates, statutory periods and local customs vary, and the live rules come from the CFPB, your state and your county. Fourteen correct (70%) matches the common passing line, but aim higher.

1. **5 pts**

   The annual percentage rate on a home loan is usually higher than the note rate because the APR:

   A. Includes finance charges such as discount points and origination fees

   B. Includes the property taxes and insurance

   C. Is computed on the sales price rather than the loan

   D. Includes the real estate commission

2. **5 pts**

   Which advertisement phrase requires the ad to disclose the down payment, the terms of repayment and the APR?

   A. “APR as low as 6.5%”

   B. “Financing available”

   C. “No closing costs”

   D. “Only $1,650 per month”

3. **5 pts**

   The three-day right of rescission under Regulation Z applies to:

   A. A purchase-money loan used to buy a principal residence

   B. A home equity line of credit secured by the borrower’s principal residence

   C. A loan to buy a rental duplex

   D. A refinance by the same lender with no new money

4. 5 pts

A homeowner signs a refinance with a new lender on a Thursday, receiving all disclosures at signing; no holiday intervenes. The right of rescission expires at midnight on:

A. Sunday

B. Monday

C. Tuesday

D. Wednesday

5. 5 pts

Which of the following is a protected basis under the Equal Credit Opportunity Act but NOT under the federal Fair Housing Act?

A. Familial status

B. Handicap

C. Race

D. Age

6. 5 pts

A buyer asks his agent to tell the lender he will live in a house that he actually plans to rent out, to get an owner-occupant rate. This request is:

A. Acceptable if he moves in within a year

B. A matter only between the buyer and his lender

C. A request to help commit occupancy fraud

D. Permitted for FHA loans only

7. 5 pts

Under RESPA Section 8, which payment is permitted?

A. A referral fee paid by one real estate broker to another for a cooperative referral

B. A fee paid by a title company to a broker for sending buyers

C. Gift cards from a lender to an agent for each referred borrower

D. A share of an inspection fee paid to the agent who recommended the inspector

8. 5 pts

Under the TRID rule, the lender must deliver or mail the Loan Estimate:

A. At the closing table

B. At least three business days before consummation

C. No later than the third business day after receiving the application

D. Within seven days after the appraisal

9. 5 pts

Two days before closing, which change requires a new Closing Disclosure and a new three-business-day waiting period?

A. The seller agrees to a $1,500 repair credit

B. The loan changes from a fixed rate to an adjustable rate

C. The recording fee rises by $40

D. The buyer’s homeowners insurance premium falls

10. 5 pts

In this example, the Loan Estimate showed $2,500 for recording fees and title services chosen from the lender’s list; at closing they total $2,830. The lender must refund:

A. $0

B. $330

C. $80

D. $250

11. 5 pts

RESPA limits the cushion a servicer may hold in a borrower’s escrow account to no more than:

A. One-sixth of the estimated annual disbursements

B. One-twelfth of the estimated annual disbursements

C. One-quarter of the estimated annual disbursements

D. One-half of the estimated annual disbursements

12. 5 pts

Which party to a deed must be legally competent for the deed to be valid?

A. The grantor

B. The grantee

C. Both the grantor and the grantee

D. The notary

13. 5 pts

An owner signs and notarizes a deed to his daughter but keeps it in his own desk, telling no one; it is found after his death. The deed is:

A. Valid, because it was notarized

B. Valid, because the daughter is identifiable

C. Valid once recorded by the daughter

D. Ineffective, because it was never delivered during the grantor's lifetime

14. 5 pts

Which deed gives the grantee the LEAST protection?

A. General warranty deed

B. Special warranty deed

C. Bargain and sale deed

D. Quitclaim deed

15. 5 pts

Which of the following is an example of involuntary alienation?

A. Escheat of an intestate owner's land to the state

B. A devise in a will

C. A gift deed to a child

D. A sale by general warranty deed

16. 5 pts

A tenant has farmed land under a written lease for 30 years and now claims title by adverse possession. The claim will most likely fail because the possession was not:

A. Open and notorious

B. Hostile

C. Continuous

D. Actual

17. 5 pts

Recording a deed in the county where the land is located gives:

A. Actual notice to the grantor’s neighbors

B. Title to the grantee

C. Constructive notice to the world

D. Validity to an otherwise defective deed

18. 5 pts

In a race-notice state, Owner deeds a lot to A, who does not record. Owner then deeds the same lot to B, who pays value without knowing of A’s deed but records only after A records. Who owns the lot?

A. B, because B had no notice

B. B, because B paid value

C. Owner, because he sold twice

D. A, because B did not record first

19. 5 pts

An owner’s title insurance policy protects the insured against:

A. Future liens the owner places on the property

B. Changes in zoning after closing

C. Covered defects in title that existed before the policy date

D. Declines in market value

20. 5 pts

In this example, annual property taxes of $4,380 are paid in arrears. Closing is April 30 (not a leap year), the seller owns the day of closing, and a 365-day year is used. The tax proration is:

A. $1,440, credit seller and debit buyer

B. $1,440, debit seller and credit buyer

C. $2,940, debit buyer and credit seller

D. $1,460, debit seller and credit buyer

ANSWER KEY

1. A. The APR expresses the total finance charge — interest plus points, origination fees and similar charges — as a yearly rate. Taxes, insurance escrows and the commission are not finance charges.
2. D. A payment amount is a triggering term. The APR alone, general phrases like "financing available," and "no closing costs" do not trigger further disclosure.
3. B. Rescission covers loans that place a security interest on a principal dwelling, such as a HELOC or a refinance with a new lender. Purchase-money loans, same-lender refinances without new money and non-residence loans are exempt.
4. B. For rescission, every day but Sundays and federal holidays counts: Friday is day 1, Saturday day 2, Sunday is skipped, Monday is day 3. Counting only weekdays gives the trap answer, Tuesday.
5. D. ECOA protects age (if the applicant can contract), marital status and public-assistance income, which the Fair Housing Act does not list. Familial status and handicap are Fair Housing Act classes; race is protected by both.
6. C. Misstating intended occupancy to obtain better terms is occupancy fraud, a federal crime. The agent must refuse and should involve the supervising broker if the buyer persists.
7. A. Section 8 expressly allows cooperative brokerage and referral arrangements between real estate brokers and agents. Payments from settlement-service providers for referrals, in any form, are prohibited kickbacks.
8. C. The Loan Estimate goes out within three business days after application. B describes the Closing Disclosure — the swap the exam loves.
9. B. Only an APR that becomes inaccurate beyond tolerance, a change in loan product, or an added prepayment penalty restarts the wait. The other changes require only a corrected disclosure at or before closing.
10. C. These charges share a 10% aggregate tolerance: $1.10 \times \$2{,}500 = \$2{,}750$, so the excess is $\$2{,}830 - \$2{,}750 = \$80$. B treats them as zero-tolerance.
11. A. The cushion may not exceed one-sixth of the year's estimated taxes and insurance — about two months. One-twelfth is the regular monthly deposit, not the cushion.
12. A. Only the grantor must be competent. The grantee need only be living (or an existing entity) and identifiable, so a minor may receive title.
13. D. Title passes only on delivery and acceptance during the grantor's life. Notarization serves recording, not validity, and recording cannot cure the lack

of delivery.

14. D. A quitclaim deed carries no warranties and conveys only whatever interest the grantor has, if any. The general warranty deed gives the most protection.
15. A. Escheat happens by operation of law when an owner dies without a will or heirs. A will, a gift deed and a sale are voluntary alienation.
16. B. Possession under a lease is by the owner's permission, so it is not hostile, and no length of permissive possession ripens into title.
17. C. Recording gives constructive notice and protects priority. Title passes on delivery, and recording cannot make a defective deed valid.
18. D. Under race-notice, a later purchaser prevails only if he had no notice and recorded first. B lacked notice but lost the race to record, so A prevails.
19. C. Title insurance looks backward: for a one-time premium it covers loss from covered defects existing before the policy date, such as forgery in the chain. It does not cover later acts, zoning or market value.
20. B. Daily rate $\$4{,}380 \div 365 = \$12$; seller's days $31 + 28 + 31 + 30 = 120$; $120 \times \$12 = \$1{,}440$. Taxes in arrears are owed by the seller for his time, so debit seller, credit buyer; A reverses the columns.

PORTFOLIO PIECE: MY PATHWAY FILE — THE CLOSING PAGES

Assemble the closing section of your Pathway File: the Fair Lending Field Guide with its triggering-term rules, rescission decision tree, ECOA list, red-flag table and audit of three real ads (6.1); the annotated sample Loan Estimate with its tolerance labels and the TRID calendar for a pretend purchase (6.2); the Anatomy of a Deed pages with a labeled recorded deed, your own pretend deed and the deed-type chart (6.3); the Chain of Title ladder traced through at least five conveyances, with its title report and cures (6.4); and the complete four-column Settlement Statement for a pretend sale, with every proration worked both ways and the books proved to balance (6.5).

Close the section with a one-page cover memo to a pretend first-time buyer, in your own words: what the three business days before closing are for, why an owner's title policy is worth its one-time premium, and how to read the debits and credits on the Closing Disclosure. Date every page; together with the Unit 5 financing pages, these documents carry a sale from application to recorded deed.

LOOK FOR	WHAT IT MEANS
Fair Lending Field Guide	Triggering terms, required disclosures and rescission rules are stated exactly, the rescission example counts Saturdays and skips Sundays correctly, and the ad audit quotes real credit terms accurately.
Loan Estimate and TRID calendar	Every closing cost on the sample is placed in the correct tolerance bucket, and the calendar uses the lender's business days for the Loan Estimate and the all-days-but-Sundays-and-holidays rule for the Closing Disclosure.
Anatomy of a Deed	All eight essential elements are identified on the recorded deed, validity is distinguished from recording, private information is protected, and the deed-type chart ranks protection correctly with the five covenants listed.
Chain of Title	At least five conveyances are traced with instrument numbers, every loan is matched to its release or flagged, and each cloud found is paired with the correct cure.
Settlement Statement	Every item is in the correct debit or credit column, prorations are worked by both the 365-day and 360-day methods with the stated day-of-closing convention, and net to seller and cash to close are computed and proved.

LOOK FOR	WHAT IT MEANS
Cover memo	Written in the student's own voice, it explains the three-day Closing Disclosure window, the owner's title policy and debits versus credits accurately and plainly, recommending no particular lender or company.

UNIT 7

Contracts

In April 1677 an English Parliament tired of perjured witnesses passed a short statute that still decides, every day, whether an American real estate deal is binding: no contract for land without a signed writing. This unit is about that writing and everything that lives inside it — the largest single section of the national exam. You will learn the elements every **valid contract** needs, and the four status words examiners love — **valid**, **void**, **voidable** and **unenforceable**. You will follow a contract to its end, through **performance** or **breach**, and learn why a court will order a seller to hand over a house through **specific performance** when it would never order him to hand over a used car. Then you will walk a real negotiation from first offer to signed **purchase agreement**: the counteroffer that kills what came before, the earnest money held in trust, the contingencies that can unwind a deal and the honest handling of multiple offers.

The unit closes with the agreements that bend the ordinary sale: the **option** that binds only one side, the **right of first refusal** that binds no one until the owner decides to sell, the **installment land contract** by which the railroads sold the prairie on ten years' credit, and finally the **lease** — a conveyance and a contract at once — with its gross, net and percentage rents, its assignments and subleases, and the law of landlord and tenant. Read every scenario slowly: on the real exam, about half of these questions apply a rule to a story.

PREREQUISITES

- Can explain the difference between real and personal property and between legal and equitable interests, from Units 1 and 2
- Can describe freehold and leasehold estates, including the estate for years and the periodic tenancy, from Lesson 2.2
- Can compute a percentage of a number and a percentage of change without a calculator for round figures
- Has the exam notebook current, with the deed and closing vocabulary from Unit 6 ready for review

MASTERY CHECKLIST

- ☐ I can list the five essential elements of a valid real estate contract and name the element missing in a scenario.
- ☐ I can classify any contract as valid, void, voidable or unenforceable, and as bilateral or unilateral and executed or executory.
- ☐ I can explain the Statute of Frauds, which real estate contracts it covers, and the part-performance exception.
- ☐ I can match breaches to remedies — specific performance, compensatory and liquidated damages, rescission — and tell assignment from novation.
- ☐ I can trace an offer through counteroffers, revocation and acceptance and say exactly when a contract is formed.
- ☐ I can explain how earnest money is held, how contingencies are satisfied or waived, and how a deposit dispute is resolved.
- ☐ I can distinguish an option, a right of first refusal, a lease-option, a lease-purchase and a contract for deed, and name the parties to each.

- ☐ I can classify lease types, compute percentage and graduated rent, and tell assignment from sublease and actual from constructive eviction.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Legal Information Institute (Cornell Law School): Statute of Frauds**: Free. A short, reliable law-school encyclopedia entry on what the Statute of Frauds covers, the writing it requires and its exceptions. Read it with Lesson 7.1, and follow its links to related entries on contracts and consideration. Ages 15 and up.
- **Legal Information Institute (Cornell Law School): Contract**: Free. The same encyclopedia's overview of contract formation, consideration, defenses and remedies, with links to each doctrine. Useful as a second explanation for Lessons 7.1 and 7.2 when a term needs another angle. Ages 15 and up.
- **Consumer Financial Protection Bureau: Owning a Home**: Free, official. The federal consumer bureau's guide to the home-buying process, including making an offer, contingencies and preparing for closing. Skim it with Lesson 7.3 to see the purchase agreement from a buyer's side. Ages 15 and up.
- **HUD: Tenant Rights, Laws and Protections**: Free, official. The Department of Housing and Urban Development's index of tenant-rights information, with links to each state's landlord-tenant resources. Use it in Lesson 7.5's project to find your own state's rules on deposits and notices. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

7.1	**What Makes a Contract Valid**	3 sessions of 50 minutes
7.2	**Performance, Breach and Remedies**	3 sessions of 50 minutes
7.3	**The Purchase Agreement**	3 sessions of 50 minutes
7.4	**Options, Rights of First Refusal and Installment Contracts**	3 sessions of 50 minutes

Unit 7 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Where a question gives figures "in this example," use them as given; real rules on deposits, notices and limitation periods vary by state. A score of 70% (14 of 20) matches the common passing line on the national exam, but aim higher. Read every scenario to the last line and choose the one BEST answer.

1. **5 pts**

   Which of the following is NOT an essential element of a valid real estate sales contract?

   A. Consideration

   B. Competent parties

   C. Earnest money

   D. A lawful object

2. **5 pts**

   A 17-year-old buys a lot from an adult seller under a signed contract. Before closing the seller gets a better offer and wants out. The contract is:

   A. Void, so the seller may sell to the new buyer

   B. Voidable by the minor only, so the seller is bound if the minor wants to proceed

   C. Voidable by either party

   D. Unenforceable because a minor signed it

3. 5 pts

A seller orally agrees to sell her farm to a neighbor, then refuses to sign anything. The neighbor has paid nothing and taken no action. The oral agreement is:

A. Void

B. Voidable by the seller

C. Illegal

D. Unenforceable

4. 5 pts

A contract in which one party makes a promise in exchange for an act, and the other party is not obligated to act, is:

A. Unilateral

B. Bilateral

C. Executed

D. Implied

5. 5 pts

A buyer and seller sign a purchase agreement; closing is set for next month. Today the contract is BEST described as:

A. Executed and unilateral

B. Executory and bilateral

C. Executed and bilateral

D. Executory and unilateral

6. 5 pts

A buyer assigns his purchase agreement to his sister, who fails to close. The seller may hold liable:

A. Only the sister, because the assignment released the buyer

B. Only the buyer, because assignments are void

C. The sister, and the buyer as well, because an assignor remains secondarily liable

D. Neither, because assignment terminates the contract

7. 5 pts

A seller refuses to close after the buyer has met every condition. The remedy that asks a court to order the seller to convey the property is:

A. Specific performance

B. Liquidated damages

C. Rescission

D. Compensatory damages

8. 5 pts

A buyer defaults on a $350,000 contract that names his $10,000 earnest money as the seller's sole remedy. The seller resells for $330,000. The seller may recover:

A. $20,000

B. $30,000

C. $10,000

D. Nothing, because the house resold

9. 5 pts

A buyer offers $290,000. The seller counters at $300,000. The buyer replies, "No — but I accept your original listing price of $295,000." The seller had never offered $295,000 except in the MLS listing. Is there a contract?

A. Yes, at $295,000, because the buyer accepted the listing price

B. Yes, at $300,000, because the seller's counter controls

C. Yes, at $290,000, because the buyer's offer came first

D. No; a listing is an invitation to negotiate, and the buyer's reply rejected the counter and made a new offer

10. 5 pts

A buyer's offer states it will remain open until Friday. On Wednesday, before the seller has responded, the buyer notifies the listing agent that he withdraws the offer. The withdrawal is:

A. Ineffective, because the offer promised to stay open

B. Effective, because an offer may be revoked any time before acceptance is communicated

C. Effective only if the buyer forfeits his earnest money

D. Ineffective unless the seller consents

11. 5 pts

When a purchase agreement is signed, the buyer acquires:

A. Legal title

B. Equitable title

C. A leasehold estate

D. A life estate

12. 5 pts

A transaction fails and both buyer and seller demand the $7,500 earnest money in the listing broker's trust account. The broker should:

A. Return it to the buyer, who deposited it

B. Pay it to the seller, the broker's client

C. Split it equally between them

D. Hold it until both parties sign a release or a court decides, or file an interpleader action

13. 5 pts

After a purchase agreement is signed, the buyer and seller agree to move the closing date back two weeks. The document they sign is:

A. An amendment

B. An addendum

C. A novation

D. A counteroffer

14. 5 pts

A listing broker has an accepted offer. Before closing, a written offer $15,000 higher arrives. The seller has not waived presentation of later offers. The broker should:

A. Reject it, because the seller is under contract

B. Tell the first buyer its terms so he can match

C. Present it to the seller promptly, noting it can be accepted only as a backup offer

D. Hold it until the first contract closes

15. 5 pts

An owner receives $5,000 in exchange for giving a developer the right to buy his land for $600,000 at any time in the next year. The owner is the:

A. Optionee, and only the developer is bound

B. Optionor, and only the owner is bound

C. Vendor, and both parties are bound

D. Optionor, and both parties are bound

16. 5 pts

A tenant's lease gives her the right to buy the building on the same terms as any offer the owner is willing to accept from a third party. This right is:

A. An option

B. A lease-purchase

C. A right of first refusal

D. An installment contract

17. 5 pts

Under an installment land contract (contract for deed), during the payment period:

A. The vendor holds legal title and the vendee holds equitable title and possession

B. The vendee holds legal title and the vendor holds a mortgage

C. A trustee holds legal title for both

D. The vendee holds legal title but not possession

18. 5 pts

A store's lease calls for $3,000 per month base rent plus 5% of annual gross sales over $500,000. Annual sales were $740,000. The annual rent is:

A. $48,000

B. $73,000

C. $36,000

D. $12,000

19. 5 pts

A tenant with ten months left on her lease rents the apartment to a friend for four months while she travels. The friend stops paying. Who owes the landlord the rent?

A. The friend, because she is in possession

B. The landlord must absorb the loss

C. Both equally, as joint tenants

D. The original tenant, because this is a sublease

20. 5 pts

A landlord fails to restore heat to an apartment for six weeks of winter despite repeated requests. The tenant moves out and stops paying rent. The tenant is MOST likely relying on:

A. Actual eviction

B. Constructive eviction

C. Quiet title

D. Retaliatory eviction

ANSWER KEY

1. C. Earnest money shows good faith but is not required; the buyer's promise to pay is consideration. A, B and D are all essential elements.
2. B. A contract with a minor is voidable only at the minor's option. The adult who chose to deal with a minor cannot use the minor's age to escape.
3. D. Under the Statute of Frauds, a contract for the sale of land must be in writing to be enforced. It is not void or illegal; if both parties voluntarily performed, it would stand.
4. A. A unilateral contract is a promise for an act; an option and an open listing are examples. A bilateral contract is a promise for a promise.
5. B. Both parties have exchanged promises (bilateral), and performance remains to be done at closing (executory). It becomes executed when fully performed.
6. C. An assignor remains secondarily liable unless the seller agrees to a novation releasing him. A describes a novation, not an assignment.
7. A. Specific performance is available because land is unique. Rescission unwinds the contract; damages pay money instead of the house.
8. C. A liquidated-damages clause that is the seller's sole remedy limits recovery to the deposit, $10,000, even though the actual loss was $20,000.
9. D. A listing price is not an offer that can be accepted. The buyer rejected the $300,000 counter, and his reply is a new offer at $295,000 that the seller may accept or not.
10. B. Without consideration paid to hold it open (which would make it an option), an offer may be revoked any time before acceptance is communicated.
11. B. The buyer holds equitable title — an enforceable interest — while the seller keeps legal title until the deed is delivered at closing.
12. D. A broker may never decide an earnest money dispute. The funds stay in trust until a mutual written release or a court order; interpleader asks a court to decide.
13. A. A change to an existing contract is an amendment, signed by both parties. An addendum is attached when the contract is formed.
14. C. Offers are presented until closing unless the seller waives that in writing; the new offer can only be a backup. Disclosing its terms to the first buyer without permission is improper.

15. B. The owner who grants the option is the optionor, and until the developer exercises it, only the optionor is bound — it is unilateral.
16. C. A right of first refusal sets no price and cannot force a sale; it lets the holder match a genuine offer if the owner decides to sell.
17. A. The vendor keeps legal title until the contract is paid as agreed; the vendee takes possession and equitable title. B describes an ordinary sale with seller-carried mortgage.
18. A. Base rent $\$3{,}000 \times 12 = \$36{,}000$; overage $0.05 \times \$240{,}000 = \$12{,}000$; total $48,000. B applies 5% to all sales and adds base rent.
19. D. Transferring part of the term is a sublease; the original tenant remains primarily liable to the landlord, who has no contract with the subtenant.
20. B. Constructive eviction applies when the landlord's failure makes the premises unfit and the tenant leaves within a reasonable time. Actual eviction is removal through the courts.

PORTFOLIO PIECE: MY PATHWAY FILE — THE CONTRACT PAGES

Assemble the contracts section of your Pathway File: the Contract Inspector's Checklist with its ten classified cases and your state's Statute of Frauds citation (7.1); the Broken-Contract Casebook with six remedy cases, the assignment and novation cases and your state's limitation period (7.2); the Offer File for 418 Alder Lane, with its timeline, earnest-money arithmetic and backup-offer note (7.3); the Three Roads to Ownership comparison of an option, a lease-option and a contract for deed (7.4); and the Lease Abstract and Rent Calculator with its three commercial tenants and your state's security-deposit rule (7.5).

Close the section with a one-page cover memo to a pretend first-time seller explaining, in your own words, what she is promising when she signs a purchase agreement, why a counteroffer ends her buyer's offer, what happens to the earnest money if the deal fails, and why you will always send her to an attorney rather than write a clause yourself. Quote Psalm 15:4 on keeping one's word. Date every page; these artifacts return in Unit 8, when the same contracts are signed by agents acting for clients.

LOOK FOR	WHAT IT MEANS
Contract Inspector's Checklist	All ten cases are classified correctly with the missing element named, every voidable case names the only party who may void it, and the state Statute of Frauds citation and lease rule are recorded and dated.
Broken-Contract Casebook	Each case chooses the right remedy with arithmetic shown, assignment and novation liability are stated correctly, and the specific-performance paragraph explains uniqueness of land in the student's own words.
Offer File	The timeline correctly marks which offers were alive and dead at each step, the earnest money and deposit deadline are computed, and buyer B's offer is handled as a confidential backup offer.
Three Roads comparison	Title, possession, obligation and money at risk are correct for all three paths, the contract-for-deed risks are paired with protections, and the closing paragraph stays neutral and ends with a referral to an attorney.
Lease Abstract and Rent	The spreadsheet reproduces $39,000 and $113,400, never charges negative overage, and the abstract records the state security-

LOOK FOR	WHAT IT MEANS
Calculator	deposit rule with its citation and date.
Cover memo	Written in the student's own voice, it explains the purchase agreement, the counteroffer rule and earnest money accurately, draws the line against drafting, and connects Psalm 15:4 to keeping a signed contract without canned language.

7.1 What Makes a Contract Valid

OBJECTIVES

- List the essential elements of a valid real estate contract — competent parties, offer and acceptance, consideration, lawful object and a signed writing — and identify which one is missing in a given scenario.
- Classify a contract as express or implied, bilateral or unilateral, and executed or executory, and explain the two meanings of "executed."
- Distinguish valid, void, voidable and unenforceable contracts and name who may void a voidable contract.
- Explain the Statute of Frauds of 1677, name the contracts it covers, and apply the part-performance and one-year-lease patterns.
- Explain how minors, incompetents, the parol evidence rule and the federal ESIGN Act and state UETA laws affect real estate contracts.

> **Warm-up.** Your neighbor shakes your hand and says, "I'll sell you my truck for $4,000 — deal?" and you say "Deal!" In the same breath he adds, "And I'll sell you the vacant lot behind my house for $40,000." You say "Deal!" again. In five minutes, write down which of these two handshakes you think a court would enforce, and why. Keep the paper — by the end of the lesson you will know the 349-year-old answer.

WATCH

Valid, Void, Voidable, & Unenforceable (Explained Simply) | Real Estate Exam Prep

Freedom Trail Realty School · 11:44

https://www.youtube.com/watch?v=m7KYMX53lfI

> **WHEN TO WATCH**
> Watch after reading the core ideas; she pauses on scenario questions — stop the video at each one, write your answer and your reason, then let her explain.

BACKUP VIDEO

Contract Law and the Writing Requirement: Satisfying the Statute of Frauds

LawShelf · 7:28

https://www.youtube.com/watch?v=Jf5F4aXjK2Q

Watch during the project session for a lawyer's view of what kind of writing satisfies the Statute; note any example that is not about land and decide whether it still applies to real estate.

KEY TERMS

contract

A voluntary, legally enforceable promise between two or more competent parties to do, or refrain from doing, some lawful act in exchange for consideration.

consideration

Something of legal value given in exchange for a promise — money, property, a promise to act or a promise to refrain from acting.

offer and acceptance (mutual assent)

The "meeting of the minds": one party proposes definite terms and the other agrees to exactly those terms, without changes.

legally competent parties

Parties who have reached the age of majority, are of sound mind and are not otherwise legally incapacitated, so that they can be bound by a contract.

Statute of Frauds

The law, descended from England's 1677 Act for Prevention of Frauds and Perjuries, requiring certain contracts — including those for the sale of real estate — to be in writing and signed by the party to be charged to be enforceable.

bilateral contract

A contract in which both parties exchange promises and both are obligated, such as a purchase agreement.

unilateral contract

A contract in which only one party makes a binding promise, and the other party is free to act or not, such as an option or an open listing.

executory contract

A contract in which something remains to be performed by one or both parties, such as a purchase agreement before closing.

executed contract

A contract that has been fully performed by all parties; in everyday practice "executed" also means simply "signed."

void contract

An agreement with no legal force or effect from the start because it lacks an essential element, such as a lawful object.

voidable contract

A contract that is valid and binding unless the party it protects — a minor, or a victim of fraud, duress or undue influence — chooses to disaffirm it.

unenforceable contract

A contract that may be valid between the parties but that a court will not enforce, such as an oral contract for the sale of land or one barred by the statute of limitations.

CORE IDEAS

The story. In seventeenth-century England, a man could lose his farm to a liar. Trials over land were decided largely on the testimony of witnesses, and the parties themselves were not even allowed to testify in their own cases. So a schemer who wanted his neighbor's fields needed only to hire a few witnesses willing to swear that, one evening in a tavern yard, the neighbor had agreed aloud to sell. The neighbor could not take the stand to deny it. In April 1677 Parliament under King Charles II answered with a short statute whose title says exactly what it was for: *An*

Act for Prevention of Frauds and Perjuries. Its drafting is traditionally credited to Lord Chancellor Nottingham and to the judge Sir Matthew Hale, who died months before it passed. Its rule was simple and permanent: certain promises — above all, contracts for the sale of land — could no longer be enforced on spoken words alone. There had to be a writing, signed by the person being held to it. Nearly 350 years later, that rule is still why every real estate purchase in America is signed on paper or on a screen.

How they figured it out. The Act did not try to make lying impossible; it moved the proof from memory to paper. Section 4 named the promises that needed "some memorandum or note thereof in writing, signed by the party to be charged": a promise by an executor to pay an estate's debts from his own pocket, a promise to answer for the debt of another, an agreement made in consideration of marriage, "any contract or sale of lands, tenements or hereditaments, or any interest in or concerning them," and any agreement not to be performed within one year. Other sections dealt with leases: an interest in land created by word of mouth was to have only the force of an estate at will, except short leases of not more than three years. Every American state adopted its own version. Most states now say that a lease of more than one year must be in writing — a few use a different period, so check your state. Courts of chancery soon softened the rule with one important exception, **part performance**: when an oral buyer has paid the price, taken possession and made improvements in reliance on the bargain, a court may enforce the oral contract rather than let the Statute become an instrument of the very fraud it was written to stop.

The big idea. A contract is a voluntary, legally enforceable promise between competent parties, supported by consideration, for a lawful purpose. Every valid real estate contract needs five **essential elements**; one memory line is "*Can Only Legal Contracts Work?*" — **C**ompetent parties, **O**ffer and acceptance, **L**awful object, **C**onsideration and a signed **W**riting. **Competent parties** are of legal age (18 in most states) and sound mind. **Offer and acceptance** — also called **mutual assent** or the **meeting of the minds** — means definite terms proposed by one party and accepted exactly by the other. **Consideration** is something of legal value exchanged: money, property, or a promise. The **lawful object** requirement means a contract to do something illegal is no contract at all. And the **Statute of Frauds** adds the fifth element for real estate: a writing signed by the party to be charged.

Contracts are also sorted three ways, and the exam asks all three. An **express contract** states its terms in words, spoken or written; an **implied contract** is shown by the parties' conduct — a buyer who accepts weeks of a broker's showings may have created an implied agency. A **bilateral contract** is a promise for a promise, so both parties are bound the moment it is accepted; a purchase agreement and an exclusive-right-to-sell listing are bilateral. A **unilateral contract** is a promise for an act: only one side is bound, and the other may act or not. An option binds only the owner; an open listing binds the seller to pay only the broker who actually produces the buyer. Finally, an **executory contract** still has something left to do — every purchase agreement is executory from acceptance until closing — while an **executed contract** has been fully performed by everyone. Be careful: in everyday real estate talk, "the buyer executed the offer" simply means the buyer signed it. On the exam, read the context; a question about performance uses the legal meaning.

Every contract has a legal status, and the four words are the most-tested vocabulary in the unit. A **valid** contract has all the essential elements and is binding and enforceable. A **void** contract was never a contract — it has no legal effect from the start because an essential element is missing: an agreement to sell a building for use as an illegal gambling house, or a deed or contract signed by a person a court has already declared incompetent. A **voidable** contract is valid until the protected party chooses to disaffirm it: a contract signed by a minor, or by someone who acted under **duress** (threats), **undue influence** (unfair pressure from a person in a position of trust), **misrepresentation** or **fraud**. Only the protected party may void it — the minor may walk away; the adult who contracted with the minor may not. A voidable contract that is not disaffirmed, or is ratified once the problem ends, stays good. An **unenforceable** contract may be perfectly valid between the parties, but a court will not enforce it: an oral contract to sell land, or one on which the **statute of limitations** has run. If both parties perform an oral land contract voluntarily, nothing undoes it.

Three more rules finish the picture. First, an **offer** must be definite, and a newspaper ad or an MLS listing is not an offer at all but an invitation to negotiate — the buyer's signed purchase offer is the first true offer. Second, consideration need not be money and need not be equal; the courts ask only whether something of value was bargained for. **Valuable consideration** has a dollar value; **good consideration** is love and affection, enough for a gift deed but not to compel a sale. Earnest money is not required to make a purchase agreement valid — the buyer's promise to pay is

consideration enough. Third, the **parol evidence rule**: once the parties put their final agreement in writing, earlier or simultaneous oral statements generally cannot be used to contradict its terms, though they may clarify an ambiguity or prove fraud. Today the "writing" and "signature" can be electronic. The federal **Electronic Signatures in Global and National Commerce Act (ESIGN)** of 2000 and the **Uniform Electronic Transactions Act (UETA)**, adopted in nearly every state, provide that a signature or record may not be denied legal effect merely because it is electronic, provided the parties have agreed to do business that way.

On the exam today. Expect three to five questions from this lesson, and most of them are scenarios. The traps are standard. A contract with a minor is *voidable by the minor* — not void, and not voidable by the adult. An oral contract to sell land is *unenforceable*, not void and not illegal; if both sides perform it, it stands. A contract to do something illegal is *void*. Duress, undue influence, misrepresentation and fraud make a contract *voidable* by the victim. "Which element is NOT required for a valid contract?" — the usual answer is earnest money, or recording, or a notary's acknowledgment; none of these is an essential element of a contract. A purchase agreement is *bilateral* and *executory*; an option is *unilateral* until exercised; a closed sale is *executed*. Most states allow a lease of one year or less to be oral. And a signed real estate contract delivered by e-mail with electronic signatures is enforceable under ESIGN and UETA. When a stem says "a court will not enforce," think unenforceable; when it says "never existed," think void; when it says "one party may choose," think voidable.

PICTURE STUDY



Sir Matthew Hale, John Michael Wright, c. 1670 · Oil on canvas · National Portrait Gallery, London

Image: Wikimedia Commons, public domain

John Michael Wright was one of the finest English-born portrait painters of the seventeenth century, a Catholic convert who trained in Scotland and Rome and painted the judges, nobles and kings of Restoration England. Around 1670 he painted Sir Matthew Hale, Chief Justice of the King's Bench, a judge famous in his own day for refusing gifts from litigants and for writing out rules for himself on impartiality. Hale is traditionally named among the lawyers who helped frame the Statute of Frauds; he died a few months before it became law in 1677. His face opens this lesson because the Statute was a judge's answer to a judge's problem: how to decide a case honestly when the witnesses may be lying.

Look closely

- Find the lettering in the upper corner. Portraits of officials were often labeled like documents — a reminder that this is a record as much as a likeness.
- Study the robes: the fur-edged mantle and ornamented band are the dress of a chief justice. Wright painted the office as carefully as the man.
- Look at the eyes and mouth. Wright gives Hale no smile and no gesture — a sober, weighing look suited to a judge who hears both sides.
- Notice how the dark oval frames the head and pushes everything else into shadow. The painting, like a well-drawn contract, leaves nothing in view but

what matters.

Talk about it

1. Before 1677, why would even an honest judge like Hale struggle to decide who had really agreed to sell a field?
2. How does requiring a signed writing protect an honest seller — and how might it occasionally help a dishonest one? What exception did the courts create for that second case?
3. Hale kept written resolutions for his own conduct as a judge. Why do you think a person of integrity might want his own promises in writing, even when no law requires it?

PROJECT

The Contract Inspector's Checklist

An experienced broker reads every contract the way a building inspector walks a house: element by element, looking for what is missing. In this project you will build a one-page checklist that tests any agreement for the five essential elements and classifies its status, then run ten pretend cases through it. You will also look up your own state's Statute of Frauds and age of majority, so the checklist fits the law you will one day practice under.

You will need

- Exam notebook, ruler and pencil (or a free spreadsheet)
- Your state legislature's official online code (search "[your state] statute of frauds real property")
- This lesson's key terms and worked examples

Steps

1. Draw a table with seven columns: Case, Competent parties?, Offer and acceptance?, Consideration?, Lawful object?, Signed writing?, Status (valid / void / voidable / unenforceable).
2. Write ten one-line pretend cases, including at least: a minor seller, an oral land sale, a sale for an illegal use, a contract signed under threat, a seller who lied about a cracked foundation, a lease of 11 months made orally, and a complete, signed purchase agreement.
3. Run each case through the table, marking each element yes or no, and write the status with a one-sentence reason.
4. For each voidable case, add a note naming the only party who may void it.
5. Look up your state's Statute of Frauds on the legislature's official site. Record its citation, the lease length that must be in writing, and the age of majority. Date the entry.
6. Add a short section titled "Two meanings of executed," with one example sentence for each.

7. Title the page “Contract Inspector’s Checklist,” date it and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, with valid / void / voidable / unenforceable as a set of four cards, each carrying one example on the back.
2. Draw a two-by-two grid: bilateral vs unilateral across the top, executory vs executed down the side, and place a purchase agreement, an option, an open listing and a closed sale in the right boxes.
3. Write a trap list titled “Status words”: minor = voidable by the minor; oral land contract = unenforceable; illegal purpose = void; earnest money = not required.

> **From history.** The 1677 Act also reached the sale of goods: its section 17 required a writing for sales of goods worth £10 or more unless the buyer took delivery or paid part of the price. That clause crossed the Atlantic, lived on in American sales law, and survives today in the Uniform Commercial Code’s section 2-201, which requires a signed writing for most sales of goods priced at $500 or more. England itself repealed most of the old Act in 1954 — but kept the writing rule for land under its property statutes.

Example 1. Exam style. A 17-year-old who inherited a small lot signs a purchase agreement to sell it to an adult investor for $30,000. Two weeks later the investor finds a buyer at $45,000 and tells the teenager he is ready to close; the teenager says he has changed his mind. The contract is BEST described as:

A. Void, because minors cannot contract

B. Voidable by either party

C. Voidable by the minor only

D. Unenforceable, because it was not recorded

Show solution

1. Check the five elements: offer and acceptance — yes; consideration — yes; lawful object — yes; signed writing — yes; competent parties — the seller is a minor.
2. The law protects minors by letting them disaffirm, not by erasing their contracts. So the contract is not void (A).
3. The protection belongs to the minor alone; the adult who chose to deal with a minor is bound if the minor elects to perform. So B is wrong.
4. Recording has nothing to do with validity between the parties, so D is a distractor.
5. The teenager has disaffirmed before reaching majority, which he is entitled to do.

Answer: C. The contract is voidable by the minor only — and he has now voided it. The investor has no claim to the lot.

Example 2. Margaret agrees aloud to sell her 10-acre pasture to her neighbor Tomas for $80,000, payable in installments. Tomas pays $20,000, moves his cattle onto the land, and builds a $15,000 barn with Margaret watching. Margaret then refuses to sign a deed. Apply the Statute of Frauds and its exception.

Show solution

1. The contract is for the sale of land, so the Statute of Frauds applies: without a writing signed by Margaret (the party to be charged), it is unenforceable in the ordinary case.
2. But the Statute was written to prevent fraud, and courts recognize the part-performance exception when the oral buyer has acted in clear reliance on the bargain.
3. The classic markers are all present: payment of part of the price, possession, and valuable improvements made with the seller's knowledge.
4. A court in most states could therefore enforce the oral contract — typically by ordering Margaret to convey on payment of the balance — rather than let her keep the barn and the payments.

Answer: Ordinarily unenforceable, but the part-performance exception very likely applies: payment, possession and improvements unmistakably point to the oral sale. The lesson for a licensee is simpler — get it in writing so no court has to decide.

Example 3. Classify each in two ways (bilateral/unilateral and executed/executory): (a) a signed purchase agreement two weeks before closing; (b) an open listing given to three brokers; (c) a 90-day option for which the buyer paid $2,000; (d) a home sale that closed last month with the deed recorded.

Show solution

1. (a) Buyer promises to buy, seller promises to sell — a promise for a promise: **bilateral**. Closing has not happened: **executory**.
2. (b) The seller promises a commission to whichever broker produces a buyer; no broker promises to do anything: **unilateral**, and **executory** until a buyer is produced.
3. (c) The owner is bound to sell at the stated price if the optionee chooses; the optionee is not bound to buy: **unilateral** and **executory**. If exercised, it becomes a bilateral contract of sale.
4. (d) Everything has been done — price paid, deed delivered: an **executed** contract. It began life as a bilateral contract.

Answer: (a) bilateral, executory; (b) unilateral, executory; (c) unilateral, executory; (d) executed (originally bilateral).

PRACTICE

1. Easy Name the five essential elements of a valid real estate sales contract.

   Show answer

   Competent parties, offer and acceptance (mutual assent), consideration, lawful object, and a writing signed by the parties as the Statute of Frauds requires. The memory line “Can Only Legal Contracts Work?” covers all five.

2. Easy What is the difference between a bilateral and a unilateral contract? Give a real estate example of each.

   Show answer

   A bilateral contract is a promise for a promise and binds both sides, like a purchase agreement. A unilateral contract is a promise for an act and binds only one side, like an option (the owner is bound; the optionee may buy or not) or an open listing.

3. Easy In what year was England's Statute of Frauds enacted, and what did it require for contracts to sell land?

Show answer

1677. It required a written memorandum signed by the party to be charged, so that land could not be lost on the strength of oral testimony alone.

4. Medium A seller signs a purchase agreement after the buyer's cousin threatens to damage his car if he doesn't. Classify the contract and say who may void it.

Show answer

Voidable, because it was signed under duress. Only the seller — the party who was threatened — may choose to void it; the buyer cannot use the duress as an excuse to escape.

5. Medium Is an advertisement in the paper reading "3-bedroom home, $350,000, call owner" an offer? Explain.

Show answer

No. An advertisement is an invitation to negotiate, not a definite offer that can be accepted. The first true offer usually comes from the buyer, in a signed purchase offer.

6. Medium A buyer and seller sign a purchase agreement with no earnest money deposit. Is it valid? Why?

Show answer

Yes. Earnest money is not one of the essential elements; the buyer's promise to pay the price is valuable consideration. Earnest money shows good faith and provides a fund for damages, but the contract stands without it.

7. Medium Explain the parol evidence rule in one sentence and give an example of how it might arise in a sale.

Show answer

Once the parties sign a final written agreement, earlier or simultaneous oral statements cannot be used to contradict its terms. If the signed contract says the refrigerator stays and the buyer later claims the seller "promised" the washer and dryer too, the oral promise generally cannot add that term.

8. Hard Two parties sign a contract to sell a building to be used for an illegal drug laboratory. Later the buyer refuses to close and the seller sues. What happens, and what status word applies?

Show answer

The court will not enforce it at all, because the contract is void — it lacked a lawful object from the start. Neither party can enforce a void agreement, and it is not merely "voidable" by one side.

9. Hard A tenant signs nothing but agrees orally to rent an apartment for 11 months at $1,200 per month. Two months in, the landlord says the oral lease is unenforceable. Who is right in most states?

Show answer

The tenant. Most states' Statutes of Frauds require a writing only for leases longer than one year, so an 11-month oral lease is generally enforceable. Check your own state, since a few use a different period.

10. Hard A seller and buyer sign a purchase agreement by electronic signature and exchange it by e-mail. The seller later argues that because he never signed in ink, there is no contract. Evaluate his argument.

Show answer

It fails. Under the federal ESIGN Act (2000) and the state versions of UETA, a signature or record may not be denied legal effect solely because it is electronic, provided the parties agreed to transact electronically — which exchanging e-signed offers shows.

11. Challenge An adult signs a contract to buy a house from a 17-year-old. Six months after turning 18, the seller has accepted the full price, moved out and said nothing. Can the seller now disaffirm? Explain using the word ratification.

Show answer

Almost certainly not. A minor may disaffirm before majority or within a reasonable time after, but by keeping the benefits of the contract for months after turning 18 without objection, the seller has ratified it by conduct, and a ratified contract is binding.

12. **Challenge** Explain why an oral contract for the sale of land is called "unenforceable" rather than "void," using what happens if both parties simply go ahead and perform it.

Show answer

Void means the agreement never had legal effect, so even a completed performance could be undone. An oral land contract is a real agreement that the courts will not compel, because the Statute of Frauds bars enforcement without a signed writing. If both parties voluntarily perform — the buyer pays and the seller deeds — the transaction stands, which is exactly why "unenforceable" is the right word.

COMMON MISTAKES

- Calling a contract with a minor "void." It is voidable — and only by the minor, never by the adult who chose to contract with him.
- Calling an oral contract to sell land "void" or "illegal." It is unenforceable under the Statute of Frauds; if both sides perform it, it stands.
- Listing earnest money, recording or notarization as an essential element of a contract. None of them is required for validity between the parties.
- Mixing up the two meanings of "executed" — in performance questions it means fully performed; in practice it often means signed.
- Treating an advertisement or MLS listing as an offer the buyer can accept. It is an invitation to negotiate; the buyer's signed offer is the offer.
- Assuming every lease must be written. Most states require a writing only for leases longer than one year.

> **Make it a game · Four Corners: Valid, Void, Voidable, Unenforceable.** Label the four corners of a room VALID, VOID, VOIDABLE and UNENFORCEABLE. One player reads a one-line contract case — a minor buys a lot; a deal for an illegal use; an oral sale of a farm; a seller tricked about a leaky roof; a complete signed contract; a claim filed after the statute of limitations ran. On "Go!" everyone walks to the corner they choose. Players in the right corner score a point; anyone who can also name the party allowed to void a voidable contract scores a bonus. Rotate the reader every five cases. Highest score after twenty cases wins, and the lowest scorer recites the five essential elements.

> **Scripture.** “And I subscribed the evidence, and sealed it, and took witnesses, and weighed him the money in the balances.” (Jeremiah 32:10, KJV)
>
> When Jeremiah bought his cousin’s field at Anathoth, he did not rely on a handshake: he signed the deed, sealed it, called witnesses and paid by honest weight. Two thousand years before the Statute of Frauds, Scripture records a land sale done the way the Statute would demand. Putting promises in writing is not distrust; it is care for the truth and for everyone who will rely on it later.

7.2 Performance, Breach and Remedies

OBJECTIVES

- Name the ways a contract is discharged — performance, agreement, impossibility and operation of law — and apply substantial and partial performance to scenarios.
- Distinguish assignment from novation and state who remains liable after each.
- Explain "time is of the essence" and identify when missing a deadline is a breach.
- Match each remedy — specific performance, compensatory damages, liquidated damages, rescission and the rare punitive award — to the situations where courts use it, and compute simple damages.
- Explain the statute of limitations, the doctrine of laches, mutual rescission, and mediation and arbitration clauses.

> **Warm-up.** You hire a painter to paint your house white with a particular brand of paint for $5,000. He finishes beautifully — but used a different brand of identical quality, and you only notice after he is gone. In five minutes, decide: should you pay him nothing, pay the full $5,000, or something in between? Write one sentence defending your choice; a famous judge will answer you below.

WATCH

Contracts: Remedies for Breach of Contract

Azure Tide All Florida School of Real Estate · 12:27

https://www.youtube.com/watch?v=D2Xo3UxtaMI

> **WHEN TO WATCH**
> Watch after core idea six; as each remedy appears on screen, write it in your notebook beside the name of the party (buyer or seller) who would usually seek it.

BACKUP VIDEO

Novation vs Assignments | Real Estate Exam Prep Videos

The Real Estate Classroom · 5:54

https://www.youtube.com/watch?v=pKOwnSexAN8

Watch before the practice set; after it, close your notebook and explain aloud who remains liable after an assignment and after a novation.

KEY TERMS

discharge

The ending of contract obligations — by performance, agreement of the parties, impossibility or operation of law.

assignment

A transfer of one party's rights under a contract to another person; the assignor generally remains liable if the assignee fails to perform.

time is of the essence

A contract clause making its deadlines strictly binding, so that failure to perform by a stated date is a breach.

specific performance

An equitable remedy in which a court orders the breaching party to do exactly what the contract requires, such as convey the property; available because every parcel of land is unique.

liquidated damages

A sum agreed in the contract, often the earnest money, as full compensation if a party breaches; enforceable if a reasonable estimate rather than a penalty.

substantial performance

Performance that departs from the contract only in minor, unintended ways, entitling the performing party to the price less damages for the defects.

novation

The substitution of a new contract or a new party for an old one by agreement of all parties, releasing the original obligor completely.

breach of contract

Failure, without legal excuse, to perform any promise that forms part of a contract.

compensatory damages

Money awarded to put the injured party in the position the contract would have produced.

rescission

Undoing a contract and returning both parties to their positions before it was made; mutual rescission is undoing it by agreement.

statute of limitations

A state law setting the time within which a lawsuit must be filed after a breach, after which the claim is barred.

laches

An equitable doctrine barring a claim when the plaintiff's unreasonable delay in asserting it has harmed the other party.

CORE IDEAS

The story. Before the First World War, a New Yorker named Kent hired the builders Jacob & Youngs to put up a country house at Lake Mahopac, at a cost of more than $77,000; it was finished in June 1914. The specifications required that all wrought-iron pipe be "of Reading manufacture." In March 1915, months after Kent had moved in, he learned that some of the plumbing pipe had been made by other mills — pipe of the same quality, appearance and price, installed through a subcontractor's oversight, now sealed inside the walls. Kent's architect ordered the pipe replaced, and Kent refused to pay the last $3,483.46. Replacing the pipe would mean tearing open the walls of a finished house. The case went to New York's highest court, and on January 25, 1921, Judge Benjamin Cardozo wrote for a narrow majority that the builder could recover. The omission was trivial and innocent, he reasoned; the house was everything Kent had bargained for in value and use. Kent was entitled to damages, but the right measure was the difference in value between Reading pipe and the pipe installed — which was nothing.

How they figured it out. Cardozo's opinion in *Jacob & Youngs v. Kent* made famous the doctrine of **substantial performance**: a party who performs in good faith, with only minor deviations, has earned the price less whatever the defects cost the other side. It did not license sloppiness — a willful substitution, or a defect that goes to the heart of the bargain, is a **material breach**, and the other party may refuse to perform and sue. The same courts had long recognized that money is not always enough. English courts of chancery, the courts of conscience that grew up beside the common-law courts, had for centuries ordered sellers of land to convey rather than merely pay damages, because no two parcels are alike: a buyer who wanted *this* house cannot buy an identical one with a damages check. That remedy, **specific performance**, is why a real estate contract is more dangerous to break than most. And chancery added its own rule of fairness, **laches**: a party who sleeps on his rights for an unreasonable time, to the other side's harm, may find the court's door closed.

The big idea. Every contract ends in one of four ways. Most end by **performance** — the buyer pays, the seller deeds, and the contract is executed. Some end by **agreement**: the parties may mutually rescind, release one another, or substitute a new contract through **novation**. Some end by **impossibility** — the subject matter is destroyed, or performance becomes illegal — though mere difficulty or expense does not excuse performance. And some end by **operation of law**: bankruptcy, the running of the statute of limitations, or a material alteration of the written contract by one party without the other's consent. Note what usually does *not* end a real estate contract: the death of a buyer or seller. Purchase agreements bind the parties' heirs and estates, which must complete the sale; it is personal-service contracts, like an agency, that end with a death. When a party fails, without legal excuse, to do what he promised, he has committed a **breach**, and the other party may choose among remedies.

Contracts may change hands. An **assignment** transfers one party's rights to another: a buyer may assign his purchase agreement to a relative who will close in his place. Most contracts are assignable unless the contract forbids it or the performance is personal — a seller who is carrying a loan himself may insist on the original buyer's credit. The catch the exam loves: after an assignment, the **assignor** remains secondarily liable if the **assignee** fails to perform. A **novation** is different: all parties agree to substitute a new party or a new contract, and the original obligor is released completely — as when a lender lets a buyer take over a seller's loan and releases the seller. If a stem asks which arrangement releases the original party, the answer is novation. Two more performance ideas: **partial performance** is doing some but not all of what was promised, which is a breach unless the other side accepts it; and a contract that says **time is of the essence** makes every date binding, so that a buyer who cannot close on the stated day is in breach even if he could close a week later. Without that clause, courts often allow a reasonable delay.

When the buyer breaches — by refusing to close without a contractual excuse — the seller commonly has three choices: keep the earnest money as **liquidated damages** if the contract says so, sue for **compensatory damages** (the actual loss, such as a lower resale price plus the costs of reselling), or, more rarely, sue for specific performance to force the purchase. Many contracts limit the seller to the earnest money; that is the point of a liquidated-damages clause — a sum agreed in advance, enforceable when it is a reasonable estimate of likely harm and not a penalty. When the seller

breaches, the buyer may sue for specific performance, sue for compensatory damages, or rescind and recover his deposit. **Rescission** unwinds the contract and returns both parties to where they began; **cancellation** and **termination** end future obligations under the contract's own terms. **Punitive damages**, meant to punish, are rarely awarded for a simple breach of contract — they belong to fraud and other wrongs, not to a buyer who changes his mind.

Time limits and private courts round out the subject. Every state sets a **statute of limitations** for contract suits — commonly several years, often longer for written contracts than for oral ones; check your state — and once it runs, the contract becomes unenforceable. Laches is chancery's cousin of that rule, applied case by case to equitable claims like specific performance. Many purchase agreements also contain dispute clauses. **Mediation** brings in a neutral person who helps the parties reach their own settlement; it is not binding unless they sign an agreement. **Arbitration** submits the dispute to a neutral arbitrator whose decision is usually binding and final, with very limited appeal. A buyer and seller who sign a contract with an arbitration clause have generally given up their right to a jury trial on that dispute — one reason a licensee should point clients to such clauses and suggest they consult an attorney. Finally, a **tender** is an unconditional offer to perform — the buyer appearing at closing with the money — and it is how a party puts the other in default before suing.

On the exam today. Expect two to four questions here, nearly all scenarios. "Which remedy asks a court to force a seller to convey?" Specific performance — justified because land is unique. "A buyer defaults; the contract makes the earnest money the seller's sole remedy." Liquidated damages; the seller keeps the deposit and may not sue for more. "Which releases the original party?" Novation, not assignment. "The buyer's deadline passes in a contract stating time is of the essence" — breach. "A seller dies after signing" — the estate must perform; the contract survives. The traps: thinking substantial performance means full payment with no deduction; calling punitive damages a normal contract remedy; confusing mediation (nonbinding help) with arbitration (binding decision); and confusing the statute of limitations (a fixed legal deadline) with laches (unreasonable delay that harms the other side). Calculations, when they appear, are simple: a seller's damages are the contract price minus the resale price, plus the extra costs of reselling.

PICTURE STUDY



House under Construction, Seattle, George Moon, c. 1910 · Photograph · University of Washington Libraries, Special Collections, Seattle

Image: Wikimedia Commons, public domain

George Moon was a Seattle photographer in the years when the city was spreading north across its hills in rows of new frame houses. Around 1910 he photographed this one, half built — the negative's jacket calls it "Moon's house," perhaps in the Latona neighborhood near Lake Union — with a man in work clothes and a woman standing proudly in front. Every house like this was built under a contract: plans, specifications, a price and a schedule. The picture opens this lesson because the questions of Jacob & Youngs v. Kent live inside every wall you see here — what was promised, what was delivered, and what happens if the two do not quite match.

Look closely

- Find the open rafters of the roof. Until the roof is on, the builder has not performed; the house is still an executory promise.
- Look at the boards of the walls. Once siding and plaster cover them, as Kent learned, the details inside are hidden — which is why specifications matter before the walls close.
- Notice the ladder and the stacks of lumber. Materials on site, ordered to the plans, are part of the builder's performance.

- Study the faces of the man and woman. Whether builders or owners, they are proud of work in progress — a reminder that most contracts end in performance, not lawsuits.

Talk about it

1. If the owners had specified one brand of pipe and the builder installed another of equal quality, how would Cardozo's rule of substantial performance apply to this house?
2. Why might a building contract say "time is of the essence" for the completion date, and what would that change if the roof were late?
3. Jesus spoke of the wise man who built his house upon a rock. What does it mean to build — and to keep a promise — so that it holds when the storms come?

PROJECT

The Broken-Contract Casebook

Lawyers learn remedies from cases, and so will you. In this project you will write six short pretend case files — three where the buyer breaks the deal and three where the seller does — and for each one decide the remedy, compute any damages, and explain why. The finished casebook becomes a quick-reference page for every remedies question on the exam.

You will need

- Exam notebook or a free spreadsheet
- A basic calculator
- This lesson's formulas and worked examples

Steps

1. Make a table with columns: Case, Who breached, Contract clauses that matter (liquidated damages? time of essence? arbitration?), Remedy available, Dollar result, One-sentence reason.
2. Write three buyer-breach cases with round pretend numbers: one with a liquidated-damages clause, one without (resale at a lower price plus costs), and one where the seller wants specific performance.
3. Write three seller-breach cases: a seller who backs out because of a higher offer, a seller whose house burns before closing, and a seller who refuses to fix a promised item.
4. Solve each case: choose the remedy, show any arithmetic, and explain why the other remedies do not fit.
5. Add one assignment case and one novation case and state who remains liable in each.
6. Below the table, write a paragraph explaining in your own words why courts will order specific performance of a land contract but rarely of a contract to sell a used car.
7. Title the page "Broken-Contract Casebook," date it and add it to your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, with assignment and novation on one card front and back so you always study them together.
2. Draw a two-column remedy chart: BUYER BREACHES (seller's options) and SELLER BREACHES (buyer's options), with specific performance, damages, liquidated damages and rescission placed correctly.
3. Write a trap list titled "Remedies": novation releases, assignment doesn't; land is unique, so specific performance; punitive damages rare in contract; mediation helps, arbitration decides; death doesn't end a sales contract.

KEY FORMULAS

$$\text{seller's damages} = (\text{contract price} - \text{resale price}) + \text{added costs of resale}$$

$$\text{earnest money} = \text{price} \times \text{deposit rate}$$

$$\text{substantial-performance recovery} = \text{contract price} - \text{damages for defects}$$

From history. Specific performance began in the English Court of Chancery, where the Lord Chancellor — originally the king's chief cleric, "keeper of the king's conscience" — could order a person to act when the common-law courts could only award money. For centuries the two systems ran side by side with separate judges and procedures. New York merged them in its 1848 Field Code of civil procedure, and most states followed, which is why a single American judge can award damages and order a conveyance in the same case.

WORKED EXAMPLES

Example 1. Exam style. A buyer contracts to purchase a house for $420,000 with a $12,000 earnest money deposit, then refuses to close without excuse. The contract has no liquidated-damages clause. The seller resells two months later for $400,000 and pays $3,500 in extra carrying costs. In this example, the seller's compensatory damages are:

A. $12,000

B. $20,000

C. $23,500

D. $11,500

Show solution

1. Price shortfall: $\$420{,}000 - \$400{,}000 = \$20{,}000$.
2. Add the extra costs caused by the breach: $\$20{,}000 + \$3{,}500 = \$23{,}500$.
3. Without a liquidated-damages clause, the seller is not limited to the deposit; he may prove his actual loss. The $12,000 held is applied toward the judgment.
4. A is the trap for assuming earnest money is always the measure; B forgets the costs.

Answer: C. $23,500 — the shortfall plus the added costs. Had the contract made the earnest money liquidated damages, the seller would keep $12,000 and nothing more.

Example 2. Ana has a signed contract to buy a lake cabin. Before closing, she assigns the contract to her brother Luis, who agrees to close. Luis fails to close. Separately, in another deal, a seller's lender agrees in writing to let a buyer take over the seller's loan and releases the seller from it. Who remains liable in each case?

Show solution

1. Ana's transfer is an **assignment**: Luis receives her rights and takes on the duties, but Ana, the assignor, is not released.
2. So when Luis fails, the seller may look to Ana as well as to Luis.
3. The lender's written release is a **novation**: a new obligor is substituted by agreement of all parties, and the original obligor is discharged.
4. So in the second deal the original seller has no further liability on the loan.

Answer: Assignment: Ana remains secondarily liable. Novation: the original seller is fully released.

Example 3. A purchase agreement states that time is of the essence and sets closing for June 30. The seller is ready; the buyer's lender is late and the buyer asks for five more days. The seller refuses and sells to a backup buyer at a higher price. The first buyer sues for specific performance. Who is likely to win, and why?

Show solution

1. Identify the clause: time is of the essence makes June 30 a binding deadline, not a target.
2. The buyer did not perform (tender the price) by the deadline, and the contract gives no extension; the lender's delay is not a legal excuse unless the contract made it one (for example, a financing contingency still running).
3. The buyer is therefore the party in breach, and a party in breach cannot obtain specific performance.
4. Without the clause, a court might have allowed a reasonable delay; with it, the seller was free to terminate.

Answer: The seller. With time of the essence, the buyer's failure to close on June 30 was a breach, and specific performance is not available to the breaching party.

PRACTICE

1. Easy Name the four general ways a contract may be discharged.

   Show answer

   By performance, by agreement of the parties (including mutual rescission and novation), by impossibility, and by operation of law (such as bankruptcy or the running of the statute of limitations).

2. Easy Why will a court order specific performance of a contract to sell land?

   Show answer

   Because every parcel of land is unique (nonhomogeneous), money damages cannot buy the buyer the same thing elsewhere, so the court orders the seller to convey.

3. **Easy** What does “time is of the essence” do to a contract’s deadlines?

Show answer

It makes them strictly binding, so a party who fails to perform by the stated date is in breach, without the reasonable grace period a court might otherwise allow.

4. **Medium** A purchase agreement for $300,000 calls for 3% earnest money and states that the deposit is the seller’s sole remedy if the buyer defaults. The buyer defaults. How much does the seller receive, and can he sue for more?

Show answer

$0.03 \times \$300{,}000 = \$9{,}000$. That is liquidated damages, and because the contract makes it the sole remedy, the seller may not sue for additional damages.

5. **Medium** How does an assignment differ from a novation in who is liable afterward?

Show answer

After an assignment, the assignee takes over but the assignor remains secondarily liable. A novation substitutes a new party or contract by everyone’s agreement and releases the original party completely.

6. **Medium** A seller signs a purchase agreement and dies before closing. Is the contract terminated?

Show answer

No. A real estate sales contract binds the seller’s estate and heirs, and the executor or administrator must complete the sale. Personal-service contracts, like a listing agency, are the ones that end at death.

7. **Medium** Distinguish mediation from arbitration.

Show answer

In mediation a neutral helps the parties reach their own settlement, and nothing is binding unless they agree. In arbitration a neutral hears the dispute and makes a decision that is usually binding, with very limited appeal.

8. Hard A builder finishes a $250,000 house exactly to plan except that the bathroom tile is a slightly different color than specified; the owner refuses to pay the last $25,000. Replacing the tile would cost $9,000, and it lowers the home's value by $1,000. Under the reasoning of Jacob & Youngs v. Kent, what is the builder likely owed?

Show answer

If the deviation was minor and in good faith, the builder substantially performed and is owed the balance minus damages. Following Cardozo's reasoning that damages should be the difference in value when the cost of correction is grossly out of proportion, the builder would recover about $\$25{,}000 - \$1{,}000 = \$24{,}000$. Courts weigh the facts, so a willful substitution could change the result.

9. Hard A buyer waits four years after a seller's breach before suing for specific performance; meanwhile the seller has spent $60,000 remodeling in reliance on the buyer's silence. Even if the statute of limitations has not run, what doctrine may defeat the suit?

Show answer

Laches — the buyer's unreasonable delay in asserting an equitable claim harmed the seller, so a court may refuse specific performance even though the statutory deadline has not passed.

10. Hard Why are punitive damages rarely awarded in a simple breach of a real estate contract, and when might a buyer seek them?

Show answer

Contract remedies aim to compensate, not punish, so a party who simply fails to perform pays the loss he caused. A buyer might seek punitive damages only where the conduct is also a wrong such as fraud — for instance, a seller who deliberately concealed a known defect.

11. **Challenge** A seller backs out of a $510,000 contract to accept a $560,000 offer. The buyer has no time-is-of-the-essence problem and has performed every condition. List the buyer's three main remedies and say which one most directly defeats the seller's purpose.

Show answer

Specific performance (force conveyance at $510,000), compensatory damages (the loss from buying a comparable home at a higher price, plus costs), or rescission with return of the deposit. Specific performance most directly defeats the seller's purpose, because it forces the sale at the original price and makes the $50,000 gain unavailable.

12. **Challenge** A contract says the buyer's earnest money of $150,000 on a $300,000 house is liquidated damages. The buyer defaults. Why might a court refuse to let the seller keep all of it?

Show answer

A liquidated-damages clause is enforced only if it is a reasonable estimate of likely harm. Fifty percent of the price looks like a penalty meant to punish default rather than to compensate, so a court may refuse to enforce it and limit the seller to actual damages.

COMMON MISTAKES

- Thinking assignment releases the original party. Only a novation releases; an assignor remains secondarily liable.
- Believing a seller's death cancels a purchase agreement. The estate is bound to complete the sale.
- Assuming the seller can always keep the earnest money and sue for more. If the contract makes the deposit liquidated damages, it is usually the seller's sole remedy.
- Treating substantial performance as full payment. The performing party recovers the price less damages for the defects.
- Calling punitive damages a standard contract remedy. They are rare and tied to fraud or similar wrongs, not mere breach.
- Confusing mediation (nonbinding, the parties settle) with arbitration (usually binding, the arbitrator decides).

Make it a game · Remedy Roulette. Write the remedies on six cards — SPECIFIC PERFORMANCE, COMPENSATORY DAMAGES, LIQUIDATED DAMAGES, RESCISSION, NOVATION, NO REMEDY — and lay them face up. A caller reads a breach story ("The seller backs out for a higher offer"; "The buyer defaults and the contract makes the deposit the sole remedy"; "The lender lets a new buyer assume and releases the seller"; "The buyer is late in a time-of-the-essence contract and sues"). Players race to slap the right card. A correct slap scores a point; explaining why the nearest wrong card is wrong scores a bonus. First to ten wins; the caller then makes up the hardest story of the night for everyone to solve together.

Scripture. "In whose eyes a vile person is contemned; but he honoureth them that fear the LORD. He that sweareth to his own hurt, and changeth not." (Psalm 15:4, KJV)

The psalmist describes the person who may dwell on God's holy hill as one who keeps his word even when it costs him. The law offers remedies when contracts are broken, but Scripture holds up a higher standard: to perform what we promised even when a better offer comes along. A seller who honors a signed contract after a higher bid arrives is living out this verse.

7.3 The Purchase Agreement

OBJECTIVES

- Trace an offer through counteroffer, revocation and acceptance, and state exactly when a contract is formed.
- Explain earnest money — who holds it, how it is deposited and how disputes over it are resolved.
- Describe equitable title, the common contingencies, kick-out clauses, and the difference between an addendum and an amendment.
- Apply the risk-of-loss rule and the rules for presenting and handling multiple offers honestly.
- Distinguish filling in an approved form from drafting, and explain why licensees must avoid the unauthorized practice of law.

> **Warm-up.** A seller lists her house at $400,000. You offer $380,000. She writes back, "I'll take $390,000." You think it over, decide you'd rather pay the full $400,000 than lose the house, and send back a signed note: "I accept your price of $400,000." In five minutes, write down whether you now have a contract — and why or why not. A farm sale from 1840 will settle it.

WATCH

Real Estate Exam Contracts EXPLAINED (Pass on Your First Try)

US Realty Training · 11:36

https://www.youtube.com/watch?v=p3BCdEn3Jg4

> **WHEN TO WATCH**
> Watch after the core ideas; at the practice questions near the end, pause and answer each one in your notebook before he does, especially the earnest money and contingency scenarios.

BACKUP VIDEO

What is a Contingency in Real Estate? (Exam Review)

Dee Kumar Real Estate · 3:55

https://www.youtube.com/watch?v=Hyt5kR5CoCI

Watch before the project; afterward, list every contingency he names and write beside each one who it protects and how it is satisfied or waived.

purchase agreement

The bilateral, executory contract in which a buyer agrees to buy and a seller agrees to sell real property on stated terms; also called a sales contract, contract of sale, offer to purchase or earnest money agreement.

offeror / offeree

The offeror makes an offer; the offeree receives it and has the power to accept it.

counteroffer

A response that changes any term of an offer; it rejects and terminates the original offer and becomes a new offer.

acceptance

The offeree's unconditional agreement to the exact terms of an offer, which forms a contract once communicated to the offeror as the offer requires.

revocation

The offeror's withdrawal of an offer, effective any time before acceptance is communicated, unless the offeror has been paid to keep it open.

earnest money

A good-faith deposit made by the buyer with the offer, held in trust by a broker, escrow agent or title company and applied to the price at closing.

equitable title

The buyer's interest in the property created by a signed purchase agreement, giving the right to acquire legal title when the contract is performed.

contingency

A condition in a contract that must be satisfied or waived before the parties are bound to close, such as financing, appraisal, inspection or sale of the buyer's home.

kick-out clause

A provision letting a seller who has accepted a contingent offer keep marketing the property and require the buyer to remove a contingency within a set time or release the contract.

addendum / amendment

An addendum is added to the contract at signing and is part of the original agreement; an amendment changes an existing contract afterward and must be signed by both parties.

unauthorized practice of law

Drafting legal documents or giving legal advice without a law license; licensees may fill in blanks on approved forms but may not draft legal clauses.

CORE IDEAS

The story. In June 1840, an English landowner named Wrench wanted to sell his farm. He had offered it to a man named Hyde for £1,200, and Hyde had declined; now, on June 6, Wrench wrote offering it for £1,000. Hyde answered two days later with an offer of £950. Wrench took his time, and on June 27 wrote that he would not accept £950. Two days later Hyde wrote back that he would pay the £1,000 after all — and when Wrench refused to sell, Hyde sued to force the sale. The Master of the Rolls, Lord Langdale, ruled against him. When Hyde offered £950, he said in effect, he made a counteroffer, and in doing so he rejected Wrench's offer of £1,000. That offer was dead, and Hyde could not bring it back to life by changing his mind. *Hyde v. Wrench* is still taught in every first-year contracts class, and its rule is still asked on every real estate licensing exam: a counteroffer terminates the original offer.

How they figured it out. The same century worked out when an acceptance takes effect. In *Adams v. Lindsell* (1818), wool dealers mailed an offer to sell wool to a firm of manufacturers on September 2, 1817, but misaddressed it; it arrived on the evening of September 5, and the buyers posted their acceptance that same night. The sellers, hearing nothing by the date they expected, sold the wool to someone else on September 8 — the day before the acceptance arrived. The court held the contract was formed when the acceptance was posted, not when it was received. That "mailbox rule" still governs ordinary mail, but modern purchase agreements avoid the problem by saying how acceptance must be communicated — commonly that a contract is formed when the signed acceptance is delivered to the offeror or the offeror's agent, by hand, e-mail or electronic platform. Together the two cases give the rhythm of every negotiation: offer, counteroffer (which kills what came before), and acceptance, which binds only when communicated the way the offer requires.

The big idea. The **purchase agreement** — also called the sales contract, contract of sale, offer to purchase, earnest money agreement or deposit receipt — is the most important document a licensee handles. It is **bilateral** and **executory**, and it typically

sets out the parties, the legal description, the price and how it will be paid, the financing terms, the earnest money, the contingencies, the closing date and the date of possession, the type of deed, the evidence of title, prorations, what stays with the property, and who bears the risk of loss — all signed by the parties. An offer may be **revoked** any time before acceptance is communicated, even if the buyer said he would keep it open, unless the seller paid for that promise (which would make it an option). An offer also ends by rejection, counteroffer, lapse of its deadline, or the death or incapacity of either party before acceptance. Acceptance must be unconditional — any change is a counteroffer. Once the agreement is signed and delivered, the buyer holds **equitable title**: an interest in the land that he may enforce, sell or pass to his heirs, while the seller keeps **legal title** until the deed is delivered at closing.

Earnest money is the buyer's good-faith deposit. It is not required for a valid contract, but nearly every offer includes one. The amount is negotiable — in this example 1% to 3% of the price. A broker who receives it must deposit it in a **trust account** (escrow account) or deliver it to the escrow agent or title company named in the contract within the time state law sets, often a few business days. Mixing client money with the broker's own funds is **commingling**; spending it is **conversion**; both are serious violations. If a deal fails and the parties disagree about who gets the deposit, the broker may not decide: the money stays in trust until both parties sign a release, a court orders its distribution, or the broker files an **interpleader** action asking a court to decide. **Contingencies** protect a party who cannot know at signing whether the deal can close: **financing** (the buyer obtains the stated loan), **appraisal** (the property appraises at least at the price), **inspection** (the buyer approves a professional inspection), **title** (the seller can deliver marketable title) and **sale of the buyer's home**. Each is satisfied, waived by the party it protects, or fails, ending the contract on its terms.

A seller who accepts an offer contingent on the sale of the buyer's home often adds a **kick-out clause** (escape clause): the seller may keep marketing the home, and if a better offer arrives, the first buyer gets a set time — in this example 72 hours — to remove the contingency or step aside. Changes are handled in writing. An **addendum** is attached when the contract is signed — the lead-paint disclosure, a well-and-septic addendum — and is part of the original agreement. An **amendment** changes the contract later — a new closing date, a repair credit — and binds only

when both parties sign it. Who bears the **risk of loss** if the house burns between signing and closing? The traditional rule put it on the buyer as holder of equitable title, but many states follow the **Uniform Vendor and Purchaser Risk Act** pattern, which leaves the risk on the seller until the buyer takes possession or legal title. Because states differ, most purchase agreements allocate the risk expressly, usually to the seller until closing. A licensee checks the state rule and the contract, and reminds both sides to keep insurance in force.

Multiple offers test a licensee's honesty more than any other moment. The listing broker must present every written offer to the seller promptly — including offers received after the seller has accepted one, until closing, unless the seller has waived that in writing — and the seller decides, not the agent. The broker may not reveal one buyer's price or terms to another buyer without the seller's permission, and may not invent competing offers. If the seller asks for "highest and best" offers, every buyer should hear the same message. Any later offer may be accepted only as a **backup offer**, contingent on the first contract failing. On drafting, the line is bright: licensees may fill in the blanks on forms approved for their use — names, dates, price, the choices the form offers — but may not write new legal clauses, interpret the law for a client, or tell a party what a document's legal effect is. That is the **unauthorized practice of law**, and the right answer is always "consult an attorney." Finally, offers, counteroffers and acceptances may be signed and delivered electronically under the ESIGN Act and UETA, but the parties' agreement must still show when and how delivery occurred.

On the exam today. This lesson carries more questions than any other in the unit, and most are scenarios. The traps: a *counteroffer terminates the original offer* — the buyer cannot later accept it; an offer can be *revoked any time before acceptance is communicated*, even if it promised to stay open (unless paid for, which makes it an option); an acceptance that changes anything, even the closing date, is a counteroffer; earnest money is *not required* and is held in a trust account, never the agent's personal account; the broker cannot decide an earnest money dispute; the buyer acquires *equitable title* at signing; a contingency may be waived only by the party it protects; an addendum is part of the original, an amendment comes later; all offers must be presented, and one buyer's terms are never disclosed to another without permission. And when a stem has the agent "writing a clause for the seller," the answer is unauthorized practice of law — refer to an attorney.

PICTURE STUDY



The Ratification of the Treaty of Münster, Gerard ter Borch, 1648 · Oil on copper · National Gallery, London (on long-term loan to the Rijksmuseum, Amsterdam)

Image: Wikimedia Commons, public domain

Gerard ter Borch, a Dutch painter of small, exquisitely detailed scenes, was in the German city of Münster in 1648 when envoys of Spain and the Dutch Republic finished negotiating the peace that ended eighty years of war between them. On May 15, 1648, in the town hall, both delegations swore to the treaty, and ter Borch painted the moment on a sheet of copper no larger than a desk blotter — dozens of portraits of real men, including, it is believed, himself at the far left. The treaty had taken years of drafts, proposals and counterproposals to settle. It opens this lesson because every purchase agreement ends the same way: after offers and counteroffers, both sides finally accept the same words.

Look closely

- Find the two men at the center holding up documents. The text of the treaty is being read aloud so that every party hears the exact terms being accepted.
- Look at the many raised right hands with two fingers lifted. The Dutch envoys are swearing to the treaty — acceptance made visible and public.
- Notice the chests and papers on the green table. Signed and sealed copies were exchanged so each side held proof of what was agreed.
- Find the crowd of witnesses packed around the room. Like the witnesses in Jeremiah's land purchase, they made the agreement a public fact.

Talk about it

1. The negotiations behind this treaty involved years of proposals and counterproposals. What happened to each earlier proposal when the other side answered with changes?
2. Why do you think both sides insisted on reading the terms aloud and swearing in front of witnesses, rather than simply signing in private?
3. After eighty years of war, both nations kept this treaty. What does it take for a person — or a people — to keep a hard-won agreement once the ceremony is over?

PROJECT

The Offer File: One House, Four Rounds

You will follow one pretend house — 418 Alder Lane, listed at $425,000 in this example — through a full negotiation: offer, counteroffer, a second buyer, acceptance, an inspection amendment and a contingency removal. For each round you will write a one-paragraph log entry as the listing broker's assistant would, recording what happened, what it did legally, and what the broker had to do next. The finished file is a model transaction for your Pathway File.

You will need

- Exam notebook or a free spreadsheet
- A blank sample purchase agreement form from your state's Realtor association or a state agency, if one is freely posted — used only to study its headings, not to fill in for real
- This lesson's key terms and worked examples

Steps

1. Draw a timeline with dates for six events: buyer A's offer at $405,000 with 2% earnest money; the seller's counter at $418,000; buyer B's written offer at $412,000; buyer A's acceptance of the counter; an inspection amendment for a $4,000 credit; and the financing contingency removal.
2. For each event, write the log entry: what document it was, who was offeror and offeree, whether any earlier offer died, and what the broker had to do (present, deposit, keep confidential).
3. Compute the earnest money, the price after the credit, and the date the deposit must be in the trust account under a rule of three business days in this example.
4. Write a paragraph explaining what happened to buyer B's offer and what the broker could honestly tell buyer B's agent.
5. If you found a sample form, list its section headings and mark each one with the matching key term from this lesson. Do not fill it in.
6. Add a closing note: "Fill in the blanks; never draft clauses — refer to an attorney."

7. Title the file “Offer File: 418 Alder Lane,” date it and add it to your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, plus a card for each way an offer can end: revocation, rejection, counteroffer, lapse of time, death or incapacity.
2. Draw a flowchart of a negotiation: OFFER → COUNTER (original dies) → COUNTER → ACCEPTANCE (communicated) → CONTRACT → contingencies satisfied or waived → CLOSING.
3. Write a trap list titled “Purchase agreement”: counteroffer kills; revoke before acceptance is communicated; earnest money optional but held in trust; broker never decides a deposit dispute; equitable title at signing; addendum now, amendment later.

KEY FORMULAS

$$\text{earnest money} = \text{offer price} \times \text{deposit rate}$$

$$\text{cash needed at closing (simplified)} = \text{price} - \text{loan} - \text{earnest money} + \text{buyer's costs}$$

From history. The name “earnest money” is older than the English language’s modern spelling. Medieval English merchants sealed bargains with an “earnest” or “God’s penny” — a small coin given at the moment of agreement, often to the church or the poor — and the Statute of Frauds of 1677 named “something in earnest to bind the bargain” as one way to make a sale of goods enforceable. Today’s deposit is far larger, and it is held in trust rather than handed over, but it still signals the same thing: this buyer means it.

Example 1. Exam style. On Monday a buyer offers $350,000 for a house, open until Friday at 5 p.m. On Tuesday the seller counters at $360,000. On Thursday the seller signs the buyer's Monday offer at $350,000 and delivers it. Is there a contract?

A. Yes, because the buyer's offer was open until Friday

B. Yes, because the seller accepted the buyer's exact terms

C. No, because the seller's counteroffer terminated the buyer's original offer

D. No, because offers must be accepted within 24 hours

Show solution

1. Monday: buyer is the offeror at $350,000.
2. Tuesday: the seller changed the price. That is a counteroffer, which rejects and terminates the Monday offer — Hyde v. Wrench.
3. Thursday: the seller tries to sign the Monday offer, but there is nothing left to accept. Her signature is at most a new offer to sell at $350,000, which the buyer may accept or not.
4. A is the trap: an offer's stated deadline does not survive a counteroffer. D is invented.

Answer: C. The counteroffer killed the original offer. The seller's Thursday signature is a new offer, not an acceptance.

Example 2. A $480,000 offer includes 2% earnest money, financing and inspection contingencies, and closing in 30 days. The inspection reveals a failing roof; the buyer asks for a $9,000 credit, and the seller agrees. Two weeks later the financing falls through despite the buyer's good-faith efforts, and the seller demands the deposit. Work through the deposit, the change and the dispute.

Show solution

1. Deposit: $0.02 \times \$480{,}000 = \$9{,}600$, deposited promptly in the broker's trust account or with the named escrow holder.
2. The repair credit changes the existing contract after acceptance, so it is an **amendment** and must be signed by both parties.
3. The financing contingency failed despite good-faith efforts, so under typical contract terms the buyer may terminate and recover the deposit.
4. The seller disagrees. The broker may not decide: the $9,600 stays in trust until both parties sign a release, a court orders distribution, or the broker files interpleader.

Answer: Earnest money $9,600, held in trust; the repair credit is an amendment signed by both; under typical terms the buyer recovers the deposit, but only a mutual release or a court can move it while the parties disagree.

Example 3. A listing broker has an accepted offer at $515,000. Before closing, a second buyer's agent calls: "What did the first buyer offer? My client will beat it by $5,000." Then a written offer arrives at $530,000. What must the listing broker do and not do?

Show solution

1. Do not reveal the first buyer's price or terms without the seller's permission; it is confidential client information and unfair to the first buyer.
2. Present the written $530,000 offer to the seller promptly — offers are presented until closing unless the seller has waived that in writing.
3. Remind the seller that a contract already binds her; the new offer can be accepted only as a backup, contingent on the first contract failing, and she should consult an attorney about her obligations.
4. Never suggest the seller invent a reason to cancel the first contract.

Answer: Keep the first offer's terms confidential, present the new offer promptly, and explain that it can only be a backup offer while the first contract stands.

PRACTICE

1. Easy What happens to an original offer when the offeree makes a counteroffer?

   Show answer

   It is rejected and terminated. The counteroffer is a new offer, and the original cannot be accepted later unless the original offeror makes it again.

2. Easy What kind of title does a buyer acquire when a purchase agreement is signed?

   Show answer

   Equitable title — an enforceable interest in the property and the right to receive legal title at closing. The seller keeps legal title until the deed is delivered.

3. Easy Is earnest money required for a purchase agreement to be valid?

Show answer

No. The buyer's promise to pay is consideration. Earnest money shows good faith and gives the seller a fund if the buyer defaults, but it is not an essential element.

4. Medium A buyer's offer says it will remain open for three days. On day two, before the seller has responded, the buyer calls the listing agent and withdraws it. Was that allowed?

Show answer

Yes. An offer may be revoked any time before acceptance is communicated, even if it promised to stay open, because the seller gave nothing for that promise. A paid promise to keep an offer open would be an option.

5. Medium The seller signs the buyer's offer but changes the closing date from June 1 to June 15. Is there a contract?

Show answer

No. Any change to the terms, even a date, makes the response a counteroffer, which the buyer may accept or reject. Acceptance must mirror the offer exactly.

6. Medium A deal fails and both buyer and seller demand the $8,000 earnest money held in the broker's trust account. What may the broker do?

Show answer

The broker must keep the money in trust and may release it only on a written release signed by both parties or a court order; the broker may also file an interpleader action asking a court to decide. The broker may never decide the dispute himself.

7. Medium What is the difference between an addendum and an amendment?

Show answer

An addendum is attached when the contract is signed and is part of the original agreement. An amendment changes the contract after it is formed and is effective only when signed by both parties.

8. Hard A seller accepts an offer contingent on the sale of the buyer's current home, with a 72-hour kick-out clause. A new buyer offers cash. Explain what happens next.

Show answer

The seller may accept the cash offer as a backup and notify the first buyer, who then has 72 hours to remove the home-sale contingency and proceed. If the first buyer removes it, the first contract stands; if not, it ends and the backup offer moves into first position.

9. Hard Two weeks before closing, the house burns down through no one's fault. The contract is silent on risk of loss, and the state follows the Uniform Vendor and Purchaser Risk Act pattern. The buyer has not moved in. Who bears the loss?

Show answer

The seller. Under the Act's pattern, risk stays with the seller until the buyer takes possession or legal title, so the buyer may cancel and recover the deposit. Most contracts settle this expressly, and a licensee should check both the contract and the state rule.

10. Hard A seller asks her listing agent to write a special clause letting her stay in the house rent-free for 60 days after closing, with conditions on damage and utilities. What should the agent do?

Show answer

Not draft it. Writing a custom legal clause is the unauthorized practice of law. The agent may use an approved post-closing occupancy addendum form if one exists for that purpose, and should advise the seller to have an attorney draft or review anything beyond the form.

11. **Challenge** A buyer offers $300,000 with $6,000 earnest money. The seller counters at $310,000. The buyer counters at $305,000. The seller signs and returns the buyer's second counter, but the buyer dies in an accident an hour before the signed copy is delivered to his agent. Is there a contract? Explain each step.

    Show answer

    The $300,000 offer died at the seller's counter, and the seller's counter died at the buyer's $305,000 counter, which was the live offer. An offer terminates on the death of the offeror before acceptance is communicated, and here delivery — the required communication — came after the death, so no contract was formed. Had the signed acceptance been delivered first, the contract would have bound the buyer's estate.

12. **Challenge** A buyer's agent asks the listing agent, "Do you have other offers, and what are they?" The seller has authorized disclosure that other offers exist but not their terms. Write the honest two-sentence answer, and explain why each part is required.

    Show answer

    "Yes, the seller has received other offers and has asked for everyone's highest and best by 5 p.m. tomorrow; I'm not able to share their terms." Disclosing that offers exist is allowed because the seller authorized it, and it must be true; withholding the terms protects the confidentiality of other buyers' offers and the seller's negotiating position.

COMMON MISTAKES

- Thinking a buyer can accept an original offer after making a counteroffer. The counteroffer terminated it.
- Believing an offer that says "open for three days" cannot be withdrawn. Without consideration paid for that promise, it may be revoked any time before acceptance is communicated.
- Letting the broker decide an earnest money dispute. The deposit stays in trust until both parties release it, a court orders it, or interpleader resolves it.
- Treating a seller's signature with a changed date or price as acceptance. Any change is a counteroffer.
- Calling a later change to an existing contract an addendum. Post-contract changes are amendments signed by both parties.

- Disclosing one buyer's offer terms to another buyer to start a bidding war. That breaches confidentiality and honest dealing.

Make it a game · Offer, Counter, Contract. Two players are buyer and seller; a third is the broker who keeps the official log. The buyer writes an offer on an index card (price, deposit, closing date). The seller may accept by signing it unchanged, or counter by writing a new card. Before each move, the broker calls out which card is "alive" and which is "dead." Twist cards drawn from a hat change the game: "The buyer revokes," "A second offer arrives," "The seller changes only the date," "The offeror dies before delivery." The broker scores a point for every correct call; any player who catches the broker in a mistake steals the point. Play three negotiations, rotating roles.

Scripture. "It is naught, it is naught, saith the buyer: but when he is gone his way, then he boasteth." (Proverbs 20:14, KJV)

Solomon describes the buyer who runs the goods down at the table and brags about his bargain afterward. Hard negotiation is not wrong, but this proverb warns against the doubleness that says one thing to win and another once the deal is done. A licensee who presents offers truthfully and keeps every party's confidences is negotiating with the integrity this verse quietly calls for.

7.4 Options, Rights of First Refusal and Installment Contracts

OBJECTIVES

- Identify the optionor and optionee, and explain why an option needs consideration, binds only the optionor, and becomes a bilateral contract when exercised.
- Distinguish a lease-option from a lease-purchase and an option from a right of first refusal.
- Describe an installment land contract (contract for deed), including the vendor's legal title, the vendee's equitable title and possession, and when the deed is delivered.
- Explain the risks of forfeiture and of the vendor's debts, and the protections — recording, notice and cure — that states provide.
- Apply the general rules for assigning contracts, options and installment contracts to scenarios, and compute option credits and installment terms.

> **Warm-up.** A friend says, "I'll hold my bike for you for a week at $200 — give me $10 and I won't sell it to anyone else." A second friend says, "If I ever decide to sell my bike, I'll let you match any offer I get." In five minutes, write down which promise gives you more power, which one costs you something, and which one forces the owner to sell to you if you want it.

WATCH

Option Agreement vs. First Right of Refusal - Teaching Tuesday - Thompson Law Group

Thompson Law Group, PLLC · 6:11

https://www.youtube.com/watch?v=cXcSXhfDTAs

> **WHEN TO WATCH**
> Watch after core idea four; as the attorney explains each device, draw a two-column chart and record who holds the power, whether the owner must sell, and what triggers it.

BACKUP VIDEO

Real Estate Exam [National] 43, Land Contracts Explained

Open Exam Prep · 4:17

https://www.youtube.com/watch?v=IgbbFZ03u3U

An audio lesson over a still title card; listen during the project session and pause to add each risk and protection it names to your contract-for-deed column.

KEY TERMS

option

A contract in which an owner, for consideration, gives another the exclusive right to buy or lease the property at a fixed price within a set period.

optionor / optionee

The optionor is the owner who grants the option and is bound by it; the optionee is the holder who may exercise it or let it expire.

option consideration

The money or other value actually paid for the option; it may or may not be credited toward the price if the option is exercised.

lease-option

A lease that gives the tenant the right, but not the obligation, to buy the property on stated terms during the lease.

lease-purchase

A lease in which the tenant agrees to buy the property on stated terms, so both parties are obligated to the sale.

right of first refusal

A right to buy or lease property on the same terms as a bona fide offer from a third party, if and when the owner decides to sell or lease.

installment land contract

A seller-financed contract in which the buyer pays in installments and takes possession, while the seller keeps legal title until the contract is paid as agreed; also called a land contract, contract for deed or agreement of sale.

vendor / vendee

In an installment land contract, the vendor is the seller who keeps legal title and the vendee is the buyer who holds equitable title and possession.

forfeiture

The loss of a defaulting vendee's rights and payments under an installment contract, subject to the notice and cure protections of state law.

memorandum of option (or contract)

A short recordable document giving public notice of an option or installment contract, protecting the holder against later buyers and lenders.

CORE IDEAS

The story. In 1872 a printer in Buffalo, New York, ran off a poster for the Burlington & Missouri River Railroad Company. "Millions of acres," it promised in enormous type — Iowa and Nebraska lands granted to the railroad by Congress, now "for sale on 10 years credit" at 6 per cent interest. The terms were printed right on the poster: only interest for the first years, then one-seventh of the principal due each year beginning four years after purchase, and a 20 percent discount for anyone who paid cash. The railroad's land commissioner, George S. Harris, offered "land exploring tickets" whose cost would be credited if the traveler bought within 30 days, and free rooms for buyers at Burlington and Lincoln. Families by the thousands bought railroad land on terms like these. A settler with a wagon and little cash could take possession of a quarter section, break the prairie, and pay for it out of the crops — but the railroad kept the title until the last payment. That arrangement is the ancestor of today's **installment land contract**, still used wherever a buyer cannot or will not borrow from a bank.

How they figured it out. Installment selling solved one problem and created another. Because the seller kept legal title, a buyer who missed a payment could, under a strict **forfeiture clause**, be put off the land and lose every payment he had made — even after years of faithful installments and improvements. Courts and legislatures spent the next century softening that rule. Some states treat an installment contract like a mortgage once the buyer has built up substantial value, requiring foreclosure rather than forfeiture. Others regulate forfeiture by statute: Washington's Real Estate Contract Forfeiture Act (1985) requires a written notice of intent to forfeit and gives the buyer a period to cure the default before the contract can be ended. Other states have added disclosure rules or recording requirements. The consumer protections differ widely, so the national exam tests the pattern, not any one state: the vendor holds legal title, the vendee holds equitable title and possession, and the vendee's great risk is forfeiture. The settlers' other tool — the power to lock up land now and decide later — grew into the **option**.

The big idea. An **option** is a contract in which an owner, the **optionor**, in exchange for consideration, gives another person, the **optionee**, the exclusive right to buy (or lease) the property at a fixed price within a stated time. Three rules define it. First, there must be **consideration** actually paid for the option itself — that is what makes the owner's promise to keep the offer open binding, unlike an ordinary offer, which can be revoked. Second, it is **unilateral**: only the optionor is bound; the optionee may exercise it or simply let it expire and lose the option money. Third, when the optionee **exercises** it, in the manner and time the option requires, it becomes a **bilateral** contract of sale binding both. Because an option is a contract to sell an interest in land, it must be in writing and contain all the terms of the eventual sale. Unless it forbids assignment, the optionee may usually assign it. The optionor's death does not end it; his estate is bound. And an optionee who **records** the option, or a memorandum of it, is protected against anyone who later buys from or lends to the optionor.

Two lease-and-buy combinations sound alike and are tested together. In a **lease-option**, the tenant leases the home and holds an option to buy it: the tenant may buy or walk away at the end of the term. Part of each month's rent is sometimes credited toward the price, in this example $200 a month. In a **lease-purchase**, the tenant leases now and *agrees* to buy later — both parties are obligated, so the tenant who fails to buy is in breach. A **right of first refusal** is weaker than an option. It gives the

holder no fixed price and no power to force a sale; it gives only the right to buy on the same terms as a genuine third-party offer, if and when the owner decides to sell. If the owner never sells, the right is never triggered. Rights of first refusal are common in leases (a tenant may match any offer for the building), condominium and cooperative documents, and family or partnership land. A licensee who lists a property subject to one must learn its terms at once, because the holder must be given notice of any acceptable offer and the stated time to match it.

An **installment land contract** — also called a **land contract**, **contract for deed**, **agreement of sale** or **conditional sales contract** — is a form of seller financing. The **vendor** (seller) keeps legal title; the **vendee** (buyer) takes possession and **equitable title** and pays the price in installments, commonly with interest. The vendor delivers the deed when the price is paid, or when a stated portion is paid, at which point the vendee may refinance. The vendee usually pays the taxes and insurance and bears the maintenance, like an owner. The risks run both ways. The vendee risks forfeiture on default, and also risks the vendor's own troubles: if the vendor has an underlying mortgage and stops paying it, or suffers a judgment lien, or dies or goes bankrupt, the vendee's path to the deed can be clouded. That is why the vendee should insist the contract or a memorandum be **recorded**, that a title search be made at the start, and that payments be made through a neutral collection agent where available. The vendor risks a vendee who stops paying and lets the property run down. Consumer protections vary by state; check yours.

Contracts in general may be assigned unless they forbid it or the performance is personal. A buyer's rights under a purchase agreement, an optionee's option and a vendee's installment contract are all commonly assignable, but each may contain a clause requiring the other party's consent. Remember the rule from Lesson 7.2: the assignor stays secondarily liable unless the other party agrees to a **novation**. A vendor who has carried the financing himself has the strongest reason to insist on consent, since he is relying on the vendee's character and credit. Also note what each device is not. An option is not a sales contract until exercised; a right of first refusal is not an option; a lease-option tenant is not an owner; and an installment vendee is not yet the legal owner, though he enjoys most of an owner's rights and burdens. Finally, an option has two prices: the **option money** paid for the right, and the **exercise price** paid for the property. Whether the first is credited toward the second is a term the parties negotiate and must write down.

On the exam today. Options and installment contracts produce two to four questions, many of them pure vocabulary. Know the *-or/-ee* rule: the one who gives is the *-or* (optionor, vendor, lessor, grantor), the one who receives is the *-ee*. The traps: an option is *unilateral* — only the optionor is bound — until exercised, when it becomes *bilateral*; an option requires actual consideration; an optionor cannot revoke during the term, but an ordinary offer can be revoked; a lease-*option* gives the tenant a choice, while a lease-*purchase* obligates him; a right of first refusal does *not* force the owner to sell — it lets the holder match an offer the owner is willing to accept; in a contract for deed, the *vendor keeps legal title* and the *vendee gets equitable title and possession*, with the deed delivered after the price is paid; the vendee's chief risk is forfeiture. When a stem asks how an optionee or vendee protects himself against later buyers, the answer is to record.

PICTURE STUDY



Ruth and Boaz, Barent Fabritius, 1660 · Oil on panel · State Hermitage Museum, Saint Petersburg

Image: Wikimedia Commons, public domain

Barent Fabritius, a Dutch painter who probably trained in Rembrandt's circle and was the younger brother of the gifted Carel Fabritius, painted this small panel in 1660. It shows Ruth, the young widow from Moab, gleaning grain in the field of Boaz, her late husband's kinsman, who points out where she may safely gather. The story goes on in Ruth 4, at the city gate, where the family field is offered first to the nearer kinsman, who holds the right of redemption, and only when he declines does Boaz buy it before the elders. That orderly honoring of a prior right to buy is the ancestor of every option and right of first refusal in this lesson.

Look closely

- Find Boaz's pointing hand. He is the owner directing what happens on his land — the one who, in Ruth 4, will honor another man's prior right before he buys.
- Look at the sheaves in Ruth's arms. Under the law of Israel, the poor and the stranger had a right to glean — a right in land that did not depend on owning it.
- Notice the reapers at work behind them. The field is being harvested by its owner's workers while others hold rights in it, as a vendee and vendor both hold interests in land under contract.

- Find the ladder and pitchfork against the sky at the left. Fabritius sets a biblical story in a Dutch farm of his own day, so his viewers would see their own fields in it.

Talk about it

1. In Ruth 4, the nearer kinsman had the first right to redeem the field. Was that more like an option or a right of first refusal? Explain your choice.
2. Why did Boaz insist on settling the kinsman's right publicly, before the elders, rather than simply buying the field himself?
3. Boaz was generous to a poor foreigner and careful to honor another man's rights. How do generosity and scrupulous fairness belong together in business?

PROJECT

Three Roads to Ownership: A Comparison Sheet

A young family in your pretend practice cannot qualify for a bank loan this year. The seller of a modest house offers three paths: a one-year option, a two-year lease-option, or a contract for deed. You will build a comparison sheet that lays out what each path costs, who holds title, who is bound, and what can go wrong — the kind of neutral explanation a licensee prepares before telling the family to see an attorney. You will not recommend a path; you will make the choices clear.

You will need

- A free spreadsheet or the exam notebook
- A basic calculator
- Your state legislature's official code site (search "[your state] real estate contract forfeiture" or "contract for deed")

Steps

1. Set pretend terms: price $260,000; option money $4,000 credited; lease-option rent $1,700 with $200 credited monthly; contract for deed with $15,000 down, 7% interest, payments over 30 years and the deed delivered after payment in full (all in this example).
2. Make a table with rows for the three paths and columns for: Who holds legal title, Who holds possession, Who is bound to buy, Money at risk if the family walks away, How the family protects itself (record? title search?), What ends it.
3. Compute the money at risk in each path after one year, showing the arithmetic for the option money and rent credits.
4. For the contract for deed, list three risks to the family (forfeiture, the vendor's mortgage, the vendor's liens or death) and the protection that answers each.
5. Look up whether your state has a statute governing forfeiture or contracts for deed. Record its citation and one protection it gives, dated.

6. Write a neutral closing paragraph explaining which facts about the family would make each path fit or not fit — without recommending one — and end with “See a real estate attorney before signing.”
7. Title the sheet “Three Roads to Ownership,” date it and add it to your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, with an -OR / -EE card listing optionor/optionee, vendor/vendee, lessor/lessee, grantor/grantee and assignor/assignee.
2. Draw a three-column table: OPTION / RIGHT OF FIRST REFUSAL / LEASE-PURCHASE, with rows for who is bound, whether a price is fixed, and what triggers the right.
3. Write a trap list titled “Options and contracts for deed”: option = unilateral until exercised; consideration required; ROFR does not force a sale; vendor keeps legal title; vendee gets equitable title and possession; record to protect yourself.

KEY FORMULAS

$$\text{net cost at exercise} = \text{exercise price} - \text{credited option money} - \text{credited rent}$$

$$\text{interest-only payment} = \text{balance} \times \text{annual rate}$$

$$\text{equal principal payment} = \frac{\text{principal}}{\text{number of payments}}$$

From history. Railroad land grants made the railroads some of the largest landowners in American history. Beginning with the Illinois Central grant of 1850 and continuing through the Pacific Railway Acts of the 1860s, Congress granted railroads alternating square-mile sections along their routes — a checkerboard pattern still visible on many western ownership maps today. The railroads paid for track by selling the land, which is why they ran land offices in Europe as well as America and printed posters in several languages.

Example 1. Exam style. A developer pays an owner $8,000 for a 12-month option to buy a parcel for $400,000, with the option money credited to the price. In month 10 the developer exercises. In this example, how much more must the developer pay at closing, and what kind of contract exists after exercise?

A. $400,000; unilateral

B. $392,000; bilateral

C. $392,000; unilateral

D. $408,000; bilateral

Show solution

1. Option money credited toward the price: $\$400{,}000 - \$8{,}000 = \$392{,}000$.
2. Before exercise, only the owner (optionor) was bound — a unilateral contract.
3. Exercise turns it into a contract of sale binding both buyer and seller — bilateral.
4. D adds the option money instead of subtracting it; A ignores the credit and the change in character.

Answer: B. $392,000 remains, and the exercised option is a bilateral contract of sale.

Example 2. A family rents a house for two years under a lease-option: purchase price \$310,000, option money \$3,000 credited, and \$250 of each month's rent credited. At the end of 24 months they exercise. What do they still owe on the price? What would be different under a lease-purchase?

Show solution

1. Rent credits: $24 \times \$250 = \$6{,}000$.
2. Total credits: $\$3{,}000 + \$6{,}000 = \$9{,}000$.
3. Remaining price: $\$310{,}000 - \$9{,}000 = \$301{,}000$.
4. Under a lease-purchase the tenants would have been *obligated* to buy; under the lease-option they could have walked away, forfeiting the option money and the credits.

Answer: They owe \$301,000 (in this example). A lease-option gives them the choice; a lease-purchase would have bound them to buy.

Example 3. Using the 1872 poster's terms: a settler contracts for 80 acres at \$6 an acre on 10 years' credit at 6% interest, interest only for the first three years, then one-seventh of the principal each year for seven years. (a) What is the price? (b) What is the cash price at 20% off? (c) What is each of the first three annual interest payments? (d) What is each principal installment?

Show solution

1. (a) Price: $80 \times \$6 = \$480$.
2. (b) Cash price: $\$480 \times (1 - 0.20) = \$384$.
3. (c) Interest only: $\$480 \times 0.06 = \$28.80$ per year for years one to three.
4. (d) Principal: $\dfrac{\$480}{7} \approx \$68.57$ per year for seven years, plus interest on the declining balance.
5. Throughout, the railroad as vendor keeps legal title; the settler as vendee holds possession and equitable title until the last payment.

Answer: (a) \$480; (b) \$384 cash; (c) \$28.80 per year; (d) about \$68.57 per year in principal, plus interest on the balance.

PRACTICE

1. Easy In an option, which party is the optionor and which is bound?

Show answer

The optionor is the owner who grants the option, and only the optionor is bound — he must sell on the stated terms if the optionee exercises within the period.

2. Easy In a contract for deed, who holds legal title and who holds equitable title?

Show answer

The vendor (seller) keeps legal title until the contract is paid as agreed; the vendee (buyer) holds equitable title and possession.

3. Easy Does a right of first refusal force the owner to sell?

Show answer

No. It gives the holder only the right to match a bona fide offer if and when the owner decides to sell; if the owner never sells, the right is never triggered.

4. Medium Why must an option be supported by consideration, when an ordinary offer need not be?

Show answer

Consideration paid for the option is what makes the owner's promise to keep the offer open binding. Without it, the "option" is just an offer that may be revoked any time before acceptance.

5. Medium Distinguish a lease-option from a lease-purchase.

Show answer

In a lease-option the tenant has the right but not the obligation to buy; in a lease-purchase the tenant has agreed to buy, so failing to buy is a breach.

6. Medium An optionee pays $5,000 for a 6-month option to buy at $275,000, not credited to the price. He exercises. What is the total cost of acquiring the property?

Show answer

$\$275{,}000 + \$5{,}000 = \$280{,}000$, because the option money was not credited. Had it been credited, he would pay $270,000 at closing for a total of $275,000.

7. Medium How does an optionee protect his option against a person who later buys the property from the optionor?

Show answer

By recording the option or a memorandum of option in the county records, which gives constructive notice to anyone who later buys from or lends to the optionor.

8. Hard An optionor dies four months into a one-year option. His heirs say the option ended with his death. Are they right?

Show answer

No. An option is a contract right in land that binds the optionor's estate; the optionee may still exercise it within the term, and the estate must convey.

9. Hard A vendee has paid on a contract for deed for six years. The vendor stops paying his own underlying mortgage, and the bank begins foreclosure. Explain the vendee's problem and two protections that would have helped.

Show answer

The vendee holds only equitable title, so the bank's foreclosure of the vendor's prior mortgage can wipe out his interest even though he paid faithfully. A title search at the start (revealing the mortgage), a recorded contract or memorandum, and payments made through a neutral collection agent that pays the underlying loan would all have helped.

10. Hard A commercial tenant holds a right of first refusal on her building. The owner receives a $900,000 offer he wants to accept. What must happen, and what if he instead sells to his nephew for $700,000 without telling her?

Show answer

He must give her notice of the offer's terms and the agreed time to match; if she matches, she buys at $900,000. Selling to the nephew without notice violates her right, and she may sue — often to buy on the same terms the nephew received or for damages, depending on the contract and the state.

11. **Challenge** Explain why an option is called unilateral, and describe precisely the moment it becomes bilateral.

Show answer

Before exercise only the optionor has a binding obligation; the optionee has a right, not a duty. The moment the optionee exercises in the manner and time the option requires — commonly by written notice and any required deposit — a bilateral contract of sale is formed binding both parties.

12. **Challenge** A family on a contract for deed has paid $40,000 in principal over eight years and made $20,000 in improvements, then misses three payments after a job loss. Under a strict forfeiture clause, what could happen, and what kinds of state protections might change the result?

Show answer

Under strict forfeiture they could lose possession and all $60,000 in payments and improvements. Many states soften this: some require a notice of intent to forfeit and a period to cure (as Washington's statute does), and some treat a contract with substantial buyer investment like a mortgage that must be foreclosed, giving the family time to cure or a share of any surplus. The details depend on the state.

COMMON MISTAKES

- Calling an option bilateral. It is unilateral — only the optionor is bound — until the optionee exercises it.
- Treating a right of first refusal like an option. A ROFR fixes no price and cannot force a sale; it only allows the holder to match a genuine offer.
- Mixing up lease-option and lease-purchase. The option gives the tenant a choice; the purchase obligates him.
- Saying the vendee receives the deed at the start of a contract for deed. The vendor keeps legal title until the contract is paid as agreed.
- Forgetting that an option needs actual consideration paid for the option itself.
- Swapping the -or and -ee parties. The giver is the -or (optionor, vendor, lessor, grantor); the receiver is the -ee.

Make it a game · Who's Bound?. Make twelve cards, each describing a deal: an option before exercise, an option after exercise, a lease-option, a lease-purchase, a right of first refusal with no offer yet, a right of first refusal with a matching offer, a contract for deed in year three, and so on. Draw a card and read it aloud. Everyone holds up one, two or zero fingers: one if only one party is bound to the sale, two if both are, zero if no one is yet bound. Then the reader asks a follow-up — "Who holds legal title?" or "Who is the -or?" A point for each right answer; three wrong in a row and you must explain the -or/-ee rule to the room. Highest score after all twelve cards wins.

Scripture. "And I thought to advertise thee, saying, Buy it before the inhabitants, and before the elders of my people. If thou wilt redeem it, redeem it: but if thou wilt not redeem it, then tell me, that I may know: for there is none to redeem it beside thee; and I am after thee. And he said, I will redeem it." (Ruth 4:4, KJV)

Under the law of Israel, the nearest kinsman held the first right to redeem a family's field — a true right of first refusal. Boaz, next in line, does not go around the nearer kinsman; he offers him the field openly before the elders and waits for his answer. Honoring someone else's prior right, in public and in order, is exactly what the law of options and first refusal asks of an honest owner.

7.5 Leases and the Law of Landlord and Tenant

OBJECTIVES

- State the essentials of a valid lease and when a lease must be in writing.
- Classify gross, net (single, double, triple), percentage, graduated, index, ground and sale-leaseback arrangements, and compute percentage and graduated rent.
- Explain the landlord's and tenant's chief rights and duties, including quiet enjoyment, the implied warranty of habitability and security deposits.
- Distinguish assignment from sublease and state who remains liable for the rent in each.
- Describe how leases end and the difference between actual and constructive eviction, and recognize illegal self-help and retaliatory evictions.

> **Warm-up.** A coffee shop pays its landlord $2,000 a month plus 5% of every dollar of sales above $400,000 a year. In five minutes, estimate what the shop pays in a year when sales reach $520,000 — and write one sentence on why a landlord might prefer this deal to a flat rent, and why the shop owner might too.

WATCH

Types of Lease Agreements | Real Estate Exam Prep Videos

The Real Estate Classroom · 7:30

https://www.youtube.com/watch?v=HchftNojrIU

> **WHEN TO WATCH**
> Watch at the start of session one, before reading core idea four; copy his whiteboard list of lease types into your notebook and add one example of who would sign each.

BACKUP VIDEO

Tenant Exit - Subleases & Assignments: Property Law 101 #77

Sara C Bronin · 5:22

https://www.youtube.com/watch?v=3V-AF-yVBzY

A law professor's short lecture; watch before worked example three and then explain the assignment-versus-sublease difference aloud without looking at your notes.

lease

A contract by which an owner (lessor) transfers the right of possession and use of property to a tenant (lessee) for a term in exchange for rent; it is both a conveyance of a leasehold estate and a contract.

net lease

A lease in which the tenant pays rent plus some or all of the property's expenses — taxes (single net), taxes and insurance (double net), or taxes, insurance and maintenance (triple net).

graduated (step) lease

A lease providing for rent increases at set intervals and in set amounts over the term.

ground lease

A long-term lease of land only, on which the tenant builds and owns improvements for the term; usually net.

covenant of quiet enjoyment

The landlord's promise that the tenant's possession will not be disturbed by the landlord or anyone claiming a superior right to the property.

gross lease

A lease in which the tenant pays a fixed rent and the landlord pays the property's taxes, insurance and maintenance; common for apartments and many offices.

percentage lease

A lease, common in retail, in which the tenant pays a base rent plus a percentage of gross sales above a stated amount, the breakpoint.

index (escalation) lease

A lease that adjusts rent periodically according to an index, such as the Consumer Price Index, or to changes in the landlord's operating costs.

sale-leaseback

A transaction in which an owner sells property and immediately leases it back, freeing capital while keeping possession.

implied warranty of habitability

The rule, adopted in most states for residential leases, that a landlord must provide and maintain premises fit to live in.

assignment vs. sublease

In an assignment the tenant transfers the entire remaining lease and the assignee pays the landlord directly; in a sublease the tenant transfers part of the term or space and remains liable to the landlord.

constructive eviction

A landlord's act or failure that makes the premises unusable for their intended purpose, allowing the tenant to move out within a reasonable time and stop paying rent.

CORE IDEAS

The story. In the spring of 1966, tenants of Clifton Terrace, a large apartment complex in Washington, D.C., stopped paying rent. Their landlord sued to evict them for nonpayment — an ordinary case. But the tenants answered that the buildings had some 1,500 violations of the city's housing regulations, from broken plumbing to failed heat, and that they should not have to pay full rent for apartments the landlord would not keep fit to live in. The trial court refused even to hear the evidence: under centuries of law, a tenant's duty to pay rent was independent of the landlord's condition of the building. On May 7, 1970, the United States Court of Appeals for the District of Columbia Circuit reversed. In *Javins v. First National Realty Corp.*, Judge J. Skelly Wright wrote that a modern apartment lease is a contract for a package of goods and services — heat, light, plumbing, safe walls — and that the law implies a **warranty of habitability** into every such lease, measured by the housing code. Within a few years most states had adopted the same rule, by court decision or by statute.

How they figured it out. The old rule made sense in its own time. The medieval lease was a conveyance of land: a farmer leased fields, and the cottage on them was an afterthought he repaired himself. The landlord promised only possession, and the rule was *caveat lessee* — tenant beware. As cities filled with apartment dwellers who could not repair a boiler or rewire a building, courts began to treat leases as contracts with mutual, dependent promises. In 1972 the National Conference of Commissioners on Uniform State Laws published the **Uniform Residential Landlord and Tenant Act (URLTA)**, a model statute balancing both sides: the landlord must keep the premises fit, follow rules on security deposits and give notice before entry; the tenant must pay rent, keep the unit clean and safe, and not damage it; and both have defined remedies. Many states adopted it in whole or in part, and many more borrowed its pattern. That is why landlord-tenant law today looks broadly similar

across the country, while the details — deposit limits, notice periods, entry rules — must always be checked in your state.

The big idea. A **lease** is two things at once: a conveyance of a **leasehold estate** (the right of possession for a term) and a contract. The owner is the **lessor** or landlord; the tenant is the **lessee**. A valid lease needs the essentials of any contract — competent parties, offer and acceptance, consideration (the rent), a lawful purpose — plus a description of the premises and the term. Under the Statute of Frauds, most states require a lease for more than one year to be in writing; a lease for one year or less may usually be oral. A lease commonly states the rent and when it is due, the security deposit, the use allowed, who repairs what, whether the tenant may assign or sublet, rules for entry, renewal options and what happens at the end. The landlord owes the tenant **possession**, **quiet enjoyment** — not freedom from noise, but freedom from interference by the landlord or anyone with a better claim to the property — and, for residences, **habitability**. The tenant owes rent, reasonable care, compliance with the rules, and the return of the premises at the end in the same condition, less **normal wear and tear**.

Leases are classified by how rent and expenses are divided. In a **gross lease**, the tenant pays a flat rent and the landlord pays taxes, insurance and maintenance — the usual apartment lease. In a **net lease**, the tenant pays rent plus some property expenses: **single net** adds the taxes; **double net** adds taxes and insurance; **triple net** (NNN) adds taxes, insurance and maintenance, so the landlord's rent arrives nearly free of expense — common in commercial property, though usage varies. A **percentage lease**, common in shopping centers, charges a base rent plus a percentage of the tenant's gross sales above a **breakpoint**. A **graduated** or **step lease** raises the rent by set amounts at set times; an **index** or **escalation lease** ties increases to an index such as the Consumer Price Index or to rising operating costs. A **ground lease** rents only the land, often for 50 to 99 years in this example, and the tenant builds; when it ends, the improvements commonly revert to the landowner. In a **sale-leaseback**, a business sells its building to an investor and leases it back, turning the value locked in its building into working capital while staying put.

A tenant who wants out early has two tools, and the exam always asks the difference. In an **assignment**, the tenant transfers the *entire* remaining term to a new tenant, the **assignee**, who then pays rent directly to the landlord; the original tenant remains secondarily liable unless the landlord releases him by novation. In a **sublease**, the

tenant transfers only part of the term or part of the space to a **subtenant**, who pays rent to the original tenant; the original tenant becomes a **sublessor** and remains primarily liable to the landlord, who has no contract with the subtenant. Most leases require the landlord's written consent to either. A **security deposit** secures the tenant's performance; states commonly cap the amount, set a deadline after move-out for its return, and require an itemized statement of any deductions — normal wear and tear may not be charged. A sale of the property does *not* end a lease: the buyer takes subject to the tenant's rights. The death of either party generally does not end a lease for a fixed term, though it does end a tenancy at will.

Leases end by **expiration** of the term, by **agreement** (a surrender accepted by the landlord), by **breach** (nonpayment or a material violation), by **destruction** of the premises (in most states, for residential and short-term leases), and by **eminent domain**, when the government condemns the property. Removing a tenant who will not leave requires **actual eviction** through the courts: proper written notice, a lawsuit (often called an unlawful detainer or forcible entry and detainer action), a judgment for possession, and removal by the sheriff or marshal under a court writ. **Constructive eviction** runs the other way: when the landlord's act or failure — no heat in winter, no water, a commercial space made unusable — makes the premises unfit for their purpose, the tenant may move out within a reasonable time and stop paying rent. The tenant must actually leave to claim it. In most states a landlord may not use **self-help** — changing the locks, removing the tenant's belongings, shutting off utilities — and may not **retaliate** against a tenant who reports code violations or joins a tenants' association. The federal Fair Housing Act applies fully to rentals.

On the exam today. Expect two to four lease questions, one of them a calculation. The percentage-lease formula is the favorite: rent equals base rent plus the percentage times sales above the breakpoint — read carefully whether figures are monthly or annual. The traps: a *sublease* leaves the original tenant liable to the landlord, while an *assignment* transfers the whole remaining term (and still leaves the assignor secondarily liable without a novation); a *triple net* tenant pays taxes, insurance and maintenance; a *gross* lease is the typical residential lease; *quiet enjoyment* means no interference with possession, not peace and quiet from neighbors; *constructive eviction* requires the tenant to leave; a landlord's sale or death does not end a lease for years; and a landlord may never lock out a tenant without a court order. A shopping-center lease with a breakpoint is percentage; a lease of land

on which the tenant builds is a ground lease; selling the building and renting it back is a sale-leaseback.

PICTURE STUDY



Pike Place Market, Seattle, Webster & Stevens, c. 1912 · Photograph · Museum of History & Industry (MOHAI), Seattle

Image: Wikimedia Commons, public domain

Webster & Stevens was the commercial photography studio of early twentieth-century Seattle, hired by newspapers, builders and businesses to record a fast-growing city. This picture shows Pike Place Market a few years after it opened in August 1907, when the city created a public market so that farmers could sell directly to households. The new Corner Market building, finished in 1912, filled with tenants: farmers renting day stalls, and shopkeepers renting stores whose rents might rise with their sales. It opens this lesson because a market is a city of leases — every stall and storefront a little estate held for a term.

Look closely

- Read the signs: “Public Market,” “Corner Market,” “Sanitary Public Market.” Each building had an owner and many tenants, each with a lease of a different kind.
- Find the arched windows of the Corner Market’s second story. Offices and small businesses above a retail floor often paid different rent on different terms.
- Look at the crowd crossing the brick street and the streetcar tracks. Foot traffic is what a retail tenant pays for — the reason percentage leases exist.

- Find the horse-drawn wagon at the left. Farmers drove in each morning to rent a stall for the day — a very short tenancy, but a tenancy still.

Talk about it

1. Which kind of lease would make sense for a busy shop in the Corner Market, and which for a farmer renting one stall for one day? Why?
2. If the market's owner sold the Corner Market building, what would happen to the shopkeepers' leases?
3. A landlord and tenant share one building and depend on each other's honesty. What would it look like for each side to "do unto others" in a lease?

PROJECT

The Lease Abstract and Rent Calculator

Property managers and investors rarely read a forty-page lease twice; they read it once and write a one-page **lease abstract** — the key terms in a table. In this project you will build a rent calculator for three pretend commercial tenants on one pretend main street and write a lease abstract for a pretend apartment, practicing both the arithmetic and the habit of reading a lease for what matters.

You will need

- A free spreadsheet (Google Sheets or LibreOffice Calc)
- A basic calculator for checking
- Your state's landlord-tenant statute on the legislature's official site, or a state attorney general's free tenant-and-landlord guide

Steps

1. Create three pretend tenants: a bookstore on a percentage lease ($2,200 base monthly plus 5% of annual sales over $500,000), a dentist on a three-year graduated lease ($2,800, $2,950, $3,100), and a sandwich shop on a triple net lease ($1,900 monthly plus its share of taxes, insurance and maintenance, $7,200 a year in this example).
2. Build formulas for each tenant's annual rent. For the bookstore, test sales of $450,000, $620,000 and $800,000; the formula must never charge negative overage.
3. Check the worked examples in this lesson with your spreadsheet: $39,000 and $113,400.
4. On a second page, write a lease abstract for a pretend 12-month apartment lease: parties, premises, term, rent and due date, deposit, who pays which utilities, assignment and sublease rules, entry notice, renewal, and move-out condition.
5. Look up your state's security-deposit rule — any cap and the deadline for return — and add it to the abstract with the citation and the date.
6. Add a short box titled "Assignment or sublease?" explaining in two sentences who would be liable in each.

7. Title the pages “Lease Abstract and Rent Calculator,” date them and add them to your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, with gross, single net, double net and triple net on one comparison card showing who pays taxes, insurance and maintenance.
2. Draw two diagrams side by side: ASSIGNMENT (landlord ← assignee, original tenant faded but still liable) and SUBLEASE (landlord ← tenant ← subtenant).
3. Write a trap list titled “Leases”: sublease = original tenant still liable; quiet enjoyment ≠ quiet; constructive eviction = tenant must leave; sale doesn’t end lease; no self-help lockouts; percentage rent only on sales above the breakpoint.

KEY FORMULAS

$$\text{percentage rent} = \text{base rent} + \text{rate} \times (\text{gross sales} - \text{breakpoint})$$

$$\text{total rent under a graduated lease} = \sum(\text{monthly rent in each step} \times \text{months in that step})$$

$$\text{annual rent} = \text{monthly rent} \times 12$$

From history. The word “rent” comes from the Old French *rente*, income — and for centuries rent was often paid in kind. Medieval English leases called for “peppercorn” rents (a single peppercorn a year, to supply nominal consideration), rents in grain or hens, or labor days on the lord’s land. The peppercorn survives as a legal phrase: a “peppercorn rent” still means a token rent that makes a lease a binding contract while transferring almost no money.

Example 1. Exam style. A shop's lease calls for base rent of $2,500 per month plus 4% of annual gross sales over $600,000. Last year the shop's gross sales were $825,000. In this example, the total annual rent was:

A. $30,000

B. $33,000

C. $39,000

D. $63,000

Show solution

1. Annual base rent: $\$2{,}500 \times 12 = \$30{,}000$.
2. Sales above the breakpoint: $\$825{,}000 - \$600{,}000 = \$225{,}000$.
3. Percentage rent: $0.04 \times \$225{,}000 = \$9{,}000$.
4. Total: $\$30{,}000 + \$9{,}000 = \$39{,}000$.
5. D applies 4% to all sales and adds base rent; A forgets the overage.

Answer: C. $39,000 — base rent plus 4% of sales above the breakpoint.

Example 2. A three-year graduated office lease charges $3,000 per month in year one, $3,150 in year two and $3,300 in year three. What is the total rent for the term, and what is the average monthly rent?

Show solution

1. Year one: $\$3{,}000 \times 12 = \$36{,}000$.
2. Year two: $\$3{,}150 \times 12 = \$37{,}800$.
3. Year three: $\$3{,}300 \times 12 = \$39{,}600$.
4. Total: $\$36{,}000 + \$37{,}800 + \$39{,}600 = \$113{,}400$; average: $\$113{,}400 \div 36 = \$3{,}150$.

Answer: Total rent $113,400; average monthly rent $3,150 (in this example).

Example 3. Jordan has 18 months left on an apartment lease at $1,500 a month. (a) He transfers the whole remaining term to Casey with the landlord's consent. (b) Instead, he rents the apartment to Casey for six months while he works out of state, intending to return. In each case, who pays the landlord, and who is liable if Casey stops paying?

Show solution

1. (a) Transferring the entire remaining term is an **assignment**. Casey, the assignee, pays the landlord directly.
2. If Casey defaults, the landlord may pursue Casey and, secondarily, Jordan — unless the landlord signed a novation releasing Jordan.
3. (b) Transferring only part of the term (Jordan keeps a reversion) is a **sublease**. Casey pays Jordan; Jordan keeps paying the landlord.
4. If Casey defaults, Jordan still owes the landlord the full rent; the landlord has no contract with Casey.

Answer: (a) Assignment: Casey pays the landlord; Jordan remains secondarily liable. (b) Sublease: Casey pays Jordan; Jordan remains primarily liable to the landlord.

PRACTICE

1. Easy In a triple net lease, which expenses does the tenant pay in addition to rent?

   Show answer

   Property taxes, insurance and maintenance. A single net adds only taxes; a double net adds taxes and insurance.

2. Easy What does the covenant of quiet enjoyment protect?

   Show answer

   The tenant's possession against interference by the landlord or anyone claiming a superior right to the property. It does not promise freedom from ordinary noise.

3. **Easy** Which type of lease is most common for apartments?

Show answer

The gross lease: the tenant pays a fixed rent, and the landlord pays the taxes, insurance and maintenance.

4. **Medium** A retailer pays $1,800 per month base rent plus 6% of annual gross sales over $300,000. Annual sales are $410,000. What is the annual rent?

Show answer

Base: $\$1{,}800 \times 12 = \$21{,}600$. Overage: $0.06 \times (\$410{,}000 - \$300{,}000) = \$6{,}600$. Total $28,200.

5. **Medium** A tenant subleases her apartment for the summer, and the subtenant stops paying. Who owes the landlord the rent?

Show answer

The original tenant. In a sublease she remains primarily liable to the landlord, who has no contract with the subtenant; she may pursue the subtenant herself.

6. **Medium** The owner of a leased duplex sells it. The new owner tells the tenant, who has eight months left, to leave in 30 days. Must the tenant go?

Show answer

No. A sale does not terminate a lease; the buyer takes the property subject to the tenant's rights for the rest of the term.

7. **Medium** Distinguish actual eviction from constructive eviction.

Show answer

Actual eviction is the landlord's removal of the tenant through the legal process — notice, lawsuit, judgment and a court-ordered removal. Constructive eviction occurs when the landlord's act or failure makes the premises unusable, and the tenant moves out and is excused from rent.

8. Hard A landlord, tired of a tenant who is two months behind, changes the locks and puts the tenant's furniture on the curb. Evaluate.

Show answer

This is an illegal self-help eviction in most states. The landlord must give proper notice, file an eviction suit, obtain a judgment and have the sheriff carry out a writ; the tenant may have claims for damages despite owing rent.

9. Hard A restaurant's landlord lets the building's only kitchen exhaust system fail and refuses to repair it for three months, so the restaurant cannot legally cook. The tenant keeps operating as a café and stops paying rent. Has the tenant established constructive eviction?

Show answer

Probably not, because constructive eviction generally requires the tenant to vacate within a reasonable time; staying in possession while withholding rent leaves the tenant exposed to an eviction for nonpayment. The tenant should consult an attorney about its lease remedies or about leaving and claiming constructive eviction.

10. Hard A company sells its headquarters to an investor for $6 million and signs a 15-year net lease to stay in the building. Name the transaction and give one reason a business might choose it.

Show answer

A sale-leaseback. The company converts the value tied up in its building into cash for operations while keeping possession, and its rent may be deductible as a business expense.

11. Challenge A store's lease requires 7% of gross sales over a breakpoint of $450,000, plus base rent of $3,000 per month. Total rent last year was $43,800. What were the store's gross sales?

Show answer

Base rent: $\$3{,}000 \times 12 = \$36{,}000$, so the overage rent was $\$43{,}800 - \$36{,}000 = \$7{,}800$. Sales over the breakpoint: $\$7{,}800 \div 0.07 \approx \$111{,}429$. Gross sales $\approx \$450{,}000 + \$111{,}429 = \$561{,}429$.

12. **Challenge** Explain why the court in Javins described an apartment lease as a contract rather than a conveyance, and how that change produced the implied warranty of habitability.

Show answer

Medieval leases conveyed land, and the tenant's duty to pay rent was independent of the landlord's; the landlord promised only possession. A modern apartment tenant bargains for a package of services — heat, water, sound walls — that only the landlord can supply, so the court treated the lease as a contract with dependent promises and implied a warranty that the premises are fit to live in, measured by the housing code.

COMMON MISTAKES

- Thinking a subtenant pays the landlord. The subtenant pays the original tenant, who remains liable to the landlord.
- Applying the percentage in a percentage lease to all sales. It applies only to sales above the breakpoint, and base rent is added separately.
- Reading "quiet enjoyment" as a promise of peace and quiet. It protects possession from interference by the landlord or someone with superior title.
- Believing a sale of the property cancels existing leases. The buyer takes subject to them.
- Claiming constructive eviction while staying in the premises. The tenant must leave within a reasonable time.
- Thinking a landlord may lock out a nonpaying tenant. Self-help evictions are illegal in most states; the court process is required.

> **Make it a game · Main Street Landlord.** One player is the landlord of a pretend main street with four storefronts. Write four tenant cards, each with a lease type and numbers: a bookstore on a percentage lease, a dentist on a step lease, a café on a triple net, an apartment upstairs on a gross lease. Roll two dice and multiply by $10,000 to set a store's "sales over the breakpoint" or a year's expenses. Players race to compute that year's rent for the card drawn. Then draw an event card — "Tenant subleases," "Building sold," "Heat fails for a month" — and the first to state the legal result correctly scores. Highest score after three rounds becomes landlord next time.

> **Scripture.** “But they shall sit every man under his vine and under his fig tree; and none shall make them afraid: for the mouth of the LORD of hosts hath spoken it.” (Micah 4:4, KJV)
>
> Micah’s picture of peace is a family settled on its own ground with no one to make them afraid — the very thing the covenant of quiet enjoyment protects on a smaller scale. A landlord who honors a tenant’s possession, and a tenant who honors the landlord’s property, are each helping the other sit secure under the fig tree, even for a term of years.

UNIT 7

Contracts

In April 1677 an English Parliament tired of perjured witnesses passed a short statute that still decides, every day, whether an American real estate deal is binding: no contract for land without a signed writing. This unit is about that writing and everything that lives inside it — the largest single section of the national exam. You will learn the elements every **valid contract** needs, and the four status words examiners love — **valid**, **void**, **voidable** and **unenforceable**. You will follow a contract to its end, through **performance** or **breach**, and learn why a court will order a seller to hand over a house through **specific performance** when it would never order him to hand over a used car. Then you will walk a real negotiation from first offer to signed **purchase agreement**: the counteroffer that kills what came before, the earnest money held in trust, the contingencies that can unwind a deal and the honest handling of multiple offers.

The unit closes with the agreements that bend the ordinary sale: the **option** that binds only one side, the **right of first refusal** that binds no one until the owner decides to sell, the **installment land contract** by which the railroads sold the prairie on ten years' credit, and finally the **lease** — a conveyance and a contract at once — with its gross, net and percentage rents, its assignments and subleases, and the law of landlord and tenant. Read every scenario slowly: on the real exam, about half of these questions apply a rule to a story.

PREREQUISITES

- Can explain the difference between real and personal property and between legal and equitable interests, from Units 1 and 2
- Can describe freehold and leasehold estates, including the estate for years and the periodic tenancy, from Lesson 2.2
- Can compute a percentage of a number and a percentage of change without a calculator for round figures
- Has the exam notebook current, with the deed and closing vocabulary from Unit 6 ready for review

MASTERY CHECKLIST

- ☐ I can list the five essential elements of a valid real estate contract and name the element missing in a scenario.
- ☐ I can classify any contract as valid, void, voidable or unenforceable, and as bilateral or unilateral and executed or executory.
- ☐ I can explain the Statute of Frauds, which real estate contracts it covers, and the part-performance exception.
- ☐ I can match breaches to remedies — specific performance, compensatory and liquidated damages, rescission — and tell assignment from novation.
- ☐ I can trace an offer through counteroffers, revocation and acceptance and say exactly when a contract is formed.
- ☐ I can explain how earnest money is held, how contingencies are satisfied or waived, and how a deposit dispute is resolved.
- ☐ I can distinguish an option, a right of first refusal, a lease-option, a lease-purchase and a contract for deed, and name the parties to each.

- ☐ I can classify lease types, compute percentage and graduated rent, and tell assignment from sublease and actual from constructive eviction.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Legal Information Institute (Cornell Law School): Statute of Frauds**: Free. A short, reliable law-school encyclopedia entry on what the Statute of Frauds covers, the writing it requires and its exceptions. Read it with Lesson 7.1, and follow its links to related entries on contracts and consideration. Ages 15 and up.
- **Legal Information Institute (Cornell Law School): Contract**: Free. The same encyclopedia's overview of contract formation, consideration, defenses and remedies, with links to each doctrine. Useful as a second explanation for Lessons 7.1 and 7.2 when a term needs another angle. Ages 15 and up.
- **Consumer Financial Protection Bureau: Owning a Home**: Free, official. The federal consumer bureau's guide to the home-buying process, including making an offer, contingencies and preparing for closing. Skim it with Lesson 7.3 to see the purchase agreement from a buyer's side. Ages 15 and up.
- **HUD: Tenant Rights, Laws and Protections**: Free, official. The Department of Housing and Urban Development's index of tenant-rights information, with links to each state's landlord-tenant resources. Use it in Lesson 7.5's project to find your own state's rules on deposits and notices. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

7.1	**What Makes a Contract Valid**	3 sessions of 50 minutes
7.2	**Performance, Breach and Remedies**	3 sessions of 50 minutes
7.3	**The Purchase Agreement**	3 sessions of 50 minutes
7.4	**Options, Rights of First Refusal and Installment Contracts**	3 sessions of 50 minutes

Unit 7 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Where a question gives figures "in this example," use them as given; real rules on deposits, notices and limitation periods vary by state. A score of 70% (14 of 20) matches the common passing line on the national exam, but aim higher. Read every scenario to the last line and choose the one BEST answer.

1. **5 pts**

   Which of the following is NOT an essential element of a valid real estate sales contract?

   A. Consideration

   B. Competent parties

   C. Earnest money

   D. A lawful object

2. **5 pts**

   A 17-year-old buys a lot from an adult seller under a signed contract. Before closing the seller gets a better offer and wants out. The contract is:

   A. Void, so the seller may sell to the new buyer

   B. Voidable by the minor only, so the seller is bound if the minor wants to proceed

   C. Voidable by either party

   D. Unenforceable because a minor signed it

3. 5 pts

A seller orally agrees to sell her farm to a neighbor, then refuses to sign anything. The neighbor has paid nothing and taken no action. The oral agreement is:

A. Void

B. Voidable by the seller

C. Illegal

D. Unenforceable

4. 5 pts

A contract in which one party makes a promise in exchange for an act, and the other party is not obligated to act, is:

A. Unilateral

B. Bilateral

C. Executed

D. Implied

5. 5 pts

A buyer and seller sign a purchase agreement; closing is set for next month. Today the contract is BEST described as:

A. Executed and unilateral

B. Executory and bilateral

C. Executed and bilateral

D. Executory and unilateral

6. 5 pts

A buyer assigns his purchase agreement to his sister, who fails to close. The seller may hold liable:

A. Only the sister, because the assignment released the buyer

B. Only the buyer, because assignments are void

C. The sister, and the buyer as well, because an assignor remains secondarily liable

D. Neither, because assignment terminates the contract

7. 5 pts

A seller refuses to close after the buyer has met every condition. The remedy that asks a court to order the seller to convey the property is:

A. Specific performance

B. Liquidated damages

C. Rescission

D. Compensatory damages

8. 5 pts

A buyer defaults on a $350,000 contract that names his $10,000 earnest money as the seller's sole remedy. The seller resells for $330,000. The seller may recover:

A. $20,000

B. $30,000

C. $10,000

D. Nothing, because the house resold

9. 5 pts

A buyer offers $290,000. The seller counters at $300,000. The buyer replies, "No — but I accept your original listing price of $295,000." The seller had never offered $295,000 except in the MLS listing. Is there a contract?

A. Yes, at $295,000, because the buyer accepted the listing price

B. Yes, at $300,000, because the seller's counter controls

C. Yes, at $290,000, because the buyer's offer came first

D. No; a listing is an invitation to negotiate, and the buyer's reply rejected the counter and made a new offer

10. 5 pts

A buyer's offer states it will remain open until Friday. On Wednesday, before the seller has responded, the buyer notifies the listing agent that he withdraws the offer. The withdrawal is:

A. Ineffective, because the offer promised to stay open

B. Effective, because an offer may be revoked any time before acceptance is communicated

C. Effective only if the buyer forfeits his earnest money

D. Ineffective unless the seller consents

11. 5 pts

When a purchase agreement is signed, the buyer acquires:

A. Legal title

B. Equitable title

C. A leasehold estate

D. A life estate

12. 5 pts

A transaction fails and both buyer and seller demand the $7,500 earnest money in the listing broker's trust account. The broker should:

A. Return it to the buyer, who deposited it

B. Pay it to the seller, the broker's client

C. Split it equally between them

D. Hold it until both parties sign a release or a court decides, or file an interpleader action

13. 5 pts

After a purchase agreement is signed, the buyer and seller agree to move the closing date back two weeks. The document they sign is:

A. An amendment

B. An addendum

C. A novation

D. A counteroffer

14. 5 pts

A listing broker has an accepted offer. Before closing, a written offer $15,000 higher arrives. The seller has not waived presentation of later offers. The broker should:

A. Reject it, because the seller is under contract

B. Tell the first buyer its terms so he can match

C. Present it to the seller promptly, noting it can be accepted only as a backup offer

D. Hold it until the first contract closes

15. 5 pts

An owner receives $5,000 in exchange for giving a developer the right to buy his land for $600,000 at any time in the next year. The owner is the:

A. Optionee, and only the developer is bound

B. Optionor, and only the owner is bound

C. Vendor, and both parties are bound

D. Optionor, and both parties are bound

16. 5 pts

A tenant's lease gives her the right to buy the building on the same terms as any offer the owner is willing to accept from a third party. This right is:

A. An option

B. A lease-purchase

C. A right of first refusal

D. An installment contract

17. 5 pts

Under an installment land contract (contract for deed), during the payment period:

A. The vendor holds legal title and the vendee holds equitable title and possession

B. The vendee holds legal title and the vendor holds a mortgage

C. A trustee holds legal title for both

D. The vendee holds legal title but not possession

18. 5 pts

A store's lease calls for $3,000 per month base rent plus 5% of annual gross sales over $500,000. Annual sales were $740,000. The annual rent is:

A. $48,000

B. $73,000

C. $36,000

D. $12,000

19. 5 pts

A tenant with ten months left on her lease rents the apartment to a friend for four months while she travels. The friend stops paying. Who owes the landlord the rent?

A. The friend, because she is in possession

B. The landlord must absorb the loss

C. Both equally, as joint tenants

D. The original tenant, because this is a sublease

20. 5 pts

A landlord fails to restore heat to an apartment for six weeks of winter despite repeated requests. The tenant moves out and stops paying rent. The tenant is MOST likely relying on:

A. Actual eviction

B. Constructive eviction

C. Quiet title

D. Retaliatory eviction

ANSWER KEY

1. C. Earnest money shows good faith but is not required; the buyer's promise to pay is consideration. A, B and D are all essential elements.
2. B. A contract with a minor is voidable only at the minor's option. The adult who chose to deal with a minor cannot use the minor's age to escape.
3. D. Under the Statute of Frauds, a contract for the sale of land must be in writing to be enforced. It is not void or illegal; if both parties voluntarily performed, it would stand.
4. A. A unilateral contract is a promise for an act; an option and an open listing are examples. A bilateral contract is a promise for a promise.
5. B. Both parties have exchanged promises (bilateral), and performance remains to be done at closing (executory). It becomes executed when fully performed.
6. C. An assignor remains secondarily liable unless the seller agrees to a novation releasing him. A describes a novation, not an assignment.
7. A. Specific performance is available because land is unique. Rescission unwinds the contract; damages pay money instead of the house.
8. C. A liquidated-damages clause that is the seller's sole remedy limits recovery to the deposit, $10,000, even though the actual loss was $20,000.
9. D. A listing price is not an offer that can be accepted. The buyer rejected the $300,000 counter, and his reply is a new offer at $295,000 that the seller may accept or not.
10. B. Without consideration paid to hold it open (which would make it an option), an offer may be revoked any time before acceptance is communicated.
11. B. The buyer holds equitable title — an enforceable interest — while the seller keeps legal title until the deed is delivered at closing.
12. D. A broker may never decide an earnest money dispute. The funds stay in trust until a mutual written release or a court order; interpleader asks a court to decide.
13. A. A change to an existing contract is an amendment, signed by both parties. An addendum is attached when the contract is formed.
14. C. Offers are presented until closing unless the seller waives that in writing; the new offer can only be a backup. Disclosing its terms to the first buyer without permission is improper.

15. B. The owner who grants the option is the optionor, and until the developer exercises it, only the optionor is bound — it is unilateral.
16. C. A right of first refusal sets no price and cannot force a sale; it lets the holder match a genuine offer if the owner decides to sell.
17. A. The vendor keeps legal title until the contract is paid as agreed; the vendee takes possession and equitable title. B describes an ordinary sale with seller-carried mortgage.
18. A. Base rent $\$3{,}000 \times 12 = \$36{,}000$; overage $0.05 \times \$240{,}000 = \$12{,}000$; total $48,000. B applies 5% to all sales and adds base rent.
19. D. Transferring part of the term is a sublease; the original tenant remains primarily liable to the landlord, who has no contract with the subtenant.
20. B. Constructive eviction applies when the landlord's failure makes the premises unfit and the tenant leaves within a reasonable time. Actual eviction is removal through the courts.

PORTFOLIO PIECE: MY PATHWAY FILE — THE CONTRACT PAGES

Assemble the contracts section of your Pathway File: the Contract Inspector's Checklist with its ten classified cases and your state's Statute of Frauds citation (7.1); the Broken-Contract Casebook with six remedy cases, the assignment and novation cases and your state's limitation period (7.2); the Offer File for 418 Alder Lane, with its timeline, earnest-money arithmetic and backup-offer note (7.3); the Three Roads to Ownership comparison of an option, a lease-option and a contract for deed (7.4); and the Lease Abstract and Rent Calculator with its three commercial tenants and your state's security-deposit rule (7.5).

Close the section with a one-page cover memo to a pretend first-time seller explaining, in your own words, what she is promising when she signs a purchase agreement, why a counteroffer ends her buyer's offer, what happens to the earnest money if the deal fails, and why you will always send her to an attorney rather than write a clause yourself. Quote Psalm 15:4 on keeping one's word. Date every page; these artifacts return in Unit 8, when the same contracts are signed by agents acting for clients.

LOOK FOR	WHAT IT MEANS
Contract Inspector's Checklist	All ten cases are classified correctly with the missing element named, every voidable case names the only party who may void it, and the state Statute of Frauds citation and lease rule are recorded and dated.
Broken-Contract Casebook	Each case chooses the right remedy with arithmetic shown, assignment and novation liability are stated correctly, and the specific-performance paragraph explains uniqueness of land in the student's own words.
Offer File	The timeline correctly marks which offers were alive and dead at each step, the earnest money and deposit deadline are computed, and buyer B's offer is handled as a confidential backup offer.
Three Roads comparison	Title, possession, obligation and money at risk are correct for all three paths, the contract-for-deed risks are paired with protections, and the closing paragraph stays neutral and ends with a referral to an attorney.
Lease Abstract and Rent	The spreadsheet reproduces $39,000 and $113,400, never charges negative overage, and the abstract records the state security-

LOOK FOR	WHAT IT MEANS
Calculator	deposit rule with its citation and date.
Cover memo	Written in the student's own voice, it explains the purchase agreement, the counteroffer rule and earnest money accurately, draws the line against drafting, and connects Psalm 15:4 to keeping a signed contract without canned language.

UNIT 8

Agency and Disclosure

In 1983 a federal survey found that most home buyers believed the agent who drove them from house to house was working for them — when, under the rules of the day, that agent legally represented the seller. This unit is about the question those buyers never thought to ask: *whom does this agent work for, and what does he owe me?* Together with contracts, it is the heaviest part of the national exam. You will learn the cast of every transaction — **principal**, **agent**, **customer** — and how an agency is created and ended. You will learn the **fiduciary duties** an agent owes a client, remembered as OLD CAR, through a New York case in which a judge held a business partner to "the punctilio of an honor the most sensitive." You will study the **listing agreement** in its four forms, work the commission arithmetic, and learn why every commission is negotiable and why fixing one is a federal offense.

Then you will turn to the buyer's side: **buyer representation agreements** and the written agreement required before touring as of 2026, **dual agency** and its limits, designated agency and the transaction broker, and the disclosure that must come first. The unit closes with what every licensee must say about the house itself — **material facts**, **latent defects**, stigmatized properties and the federal lead-based paint rule — and the long road from *caveat emptor* to the disclosure statement. Read each scenario asking two questions: who is the client, and what does the truth require?

PREREQUISITES

- Can explain the elements of a valid contract and the difference between bilateral and unilateral contracts, from Lesson 7.1
- Can explain earnest money, trust accounts and the handling of multiple offers, from Lesson 7.3
- Can compute a percentage of a number and a share of a share (for example, 60% of half of 5% of a price)
- Has the exam notebook current, with the environmental hazards from Lesson 3.5 ready for review

MASTERY CHECKLIST

- ☐ I can identify the principal, agent and customers in any transaction and classify an agent as universal, general or special.
- ☐ I can explain how agency is created and terminated, and why compensation does not determine agency.
- ☐ I can name and apply the six fiduciary duties of OLD CAR and the duties owed to customers.
- ☐ I can distinguish puffing, negligent and intentional misrepresentation, and fraud, and identify a secret profit.
- ☐ I can tell the four listing types apart, explain protection clauses and procuring cause, and compute commission splits.
- ☐ I can explain that commissions are negotiable, that fixing them is illegal, and the 2024 MLS rules on compensation offers and written buyer agreements.
- ☐ I can explain dual, designated and transaction-broker relationships, the consent dual agency requires, and when agency must be disclosed.

- ☐ I can decide what must be disclosed about a property, including latent defects, stigmatized-property rules and the lead-based paint requirements for pre-1978 housing.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Washington State Legislature: RCW 18.86.120, the Pamphlet on the Law of Real Estate Agency**: Free, official. The full text of the agency pamphlet Washington brokers must give buyers and sellers, a clear plain-language statement of the duties owed to clients and to all parties. Read it with Lessons 8.2 and 8.4, then find your own state's version. Ages 15 and up.
- **EPA: Real Estate Disclosures about Potential Lead Hazards**: Free, official. The Environmental Protection Agency's page on the federal lead-based paint disclosure rule for sales and leases of pre-1978 housing, with the required pamphlet and sample disclosure forms. Use it for Lesson 8.5's project. Ages 14 and up.
- **Legal Information Institute (Cornell Law School): Agency**: Free. A law-school encyclopedia entry on the law of agency — principals, agents, authority and fiduciary duty — with links to related doctrines. A second explanation for Lessons 8.1 and 8.2. Ages 15 and up.
- **FEMA Flood Map Service Center**: Free, official. Look up the official flood map for any address and read its flood zone. Use it for the extension in Lesson 8.5 with a public landmark rather than a private home. Ages 14 and up.
- **Consumer Financial Protection Bureau: Buying a House**: Free, official. The federal consumer bureau's step-by-step guide for home buyers, including working with a real estate professional and reviewing disclosures. Skim it with Lesson 8.4 to see agency from the buyer's chair. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

8.1	**What Agency Is: Principals, Agents and Customers**	3 sessions of 50 minutes
8.2	**The Fiduciary Duties**	3 sessions of 50 minutes

8.3	**Listing Agreements**	3 sessions of 50 minutes
8.4	**Buyer Agency, Dual Agency and Other Relationships**	3 sessions of 50 minutes
8.5	**Property Disclosures and Material Facts**	3 sessions of 50 minutes

Unit 8 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Commission rates and other figures marked “in this example” are examples only — commissions are always negotiable, and disclosure and agency rules vary by state. A score of 70% (14 of 20) matches the common passing line on the national exam, but aim higher. For each scenario, first decide who is the client, then choose the one BEST answer.

1. **5 pts**

   A broker who is hired under a listing agreement to find a buyer for one house is a:

   A. Universal agent

   B. General agent

   C. Special agent

   D. Subagent

2. **5 pts**

   A buyer’s broker is paid at closing from a concession the seller agreed to make. Whom does the buyer’s broker represent?

   A. The buyer

   B. The seller, who is paying

   C. Both parties as a dual agent

   D. Neither party

3. 5 pts

All of the following terminate an agency by operation of law EXCEPT:

A. Death of the principal

B. Destruction of the property

C. Bankruptcy of the principal

D. Expiration of the listing term

4. 5 pts

A broker, acting without authority, negotiates an offer on an owner's vacant lot. The owner accepts the offer and agrees at closing to pay the broker's fee. The agency was created by:

A. Estoppel

B. Ratification

C. Express agreement in advance

D. Implication from the buyer's conduct

5. 5 pts

A listing agent tells a buyer, "The seller just lost his job and must sell this month — offer low." The agent has breached the duty of:

A. Obedience

B. Accounting

C. Reasonable care

D. Confidentiality

6. 5 pts

A seller instructs his agent not to show the home to a family because of their national origin. The agent should:

A. Refuse, because the instruction is unlawful under the Fair Housing Act

B. Comply, because of the duty of obedience

C. Comply, but only for the term of the listing

D. Comply, but disclose the instruction to the family

7. 5 pts

A listing agent says a house has “the most charming kitchen in the county.” This statement is BEST described as:

A. Fraud

B. Negligent misrepresentation

C. Puffing

D. Intentional misrepresentation

8. 5 pts

A licensee lists a home and, without telling the seller, arranges for her brother-in-law to buy it below market so they can resell it for a profit. Her conduct is primarily a breach of:

A. Loyalty, through an undisclosed secret profit

B. Accounting

C. Obedience

D. Nothing, if the price was the listing price

9. 5 pts

An owner lists with Broker A under an exclusive-agency listing. During the term, the owner sells to a friend he found himself. The owner owes Broker A:

A. The full commission

B. Half the commission

C. Reimbursement of advertising only, if the listing says so

D. Nothing

10. 5 pts

A house sells for $350,000. In this example, the commission is 6%, split equally between the listing and selling brokerages, and the selling agent receives 60% of her firm’s share. The selling agent earns:

A. $21,000

B. $6,300

C. $10,500

D. $12,600

11. 5 pts

Which listing type is illegal or discouraged in many states because the broker keeps everything above the seller's stated amount?

A. Net listing

B. Open listing

C. Exclusive agency

D. Exclusive right to sell

12. 5 pts

Who sets the commission rate in a residential listing?

A. The state real estate commission

B. The local MLS

C. The broker and the seller, by negotiation

D. The national association of brokers

13. 5 pts

A listing expires June 30. It contains a 90-day protection clause, and the broker gave the seller a written list of buyers he showed the home. On August 15 the seller, who has not relisted, sells to a buyer on that list. The broker:

A. Is owed nothing, because the listing expired

B. Is owed the commission under the protection clause

C. Is owed half the commission

D. Must sue for procuring cause instead

14. 5 pts

As of 2026, under MLS rules adopted in August 2024, which statement is correct?

A. Listing brokers must publish offers of compensation on the MLS

B. Buyers may tour homes with an agent and sign an agreement only at closing

C. Buyer-broker commissions are set by the MLS

D. A licensee working with a buyer must have a written agreement with the buyer before touring a home

15. 5 pts

One brokerage represents both the buyer and the seller in the same transaction with both parties' informed written consent. The brokerage may:

A. Tell the seller the buyer will pay more than offered

B. Disclose to the buyer a known leak in the basement

C. Advise the buyer to offer less than list price

D. Tell the buyer the seller's lowest acceptable price

16. 5 pts

A brokerage's managing broker appoints one licensee to represent the seller and a different licensee to represent the buyer in an in-house sale. This arrangement is:

A. Undisclosed dual agency

B. Subagency

C. Designated agency

D. Transaction brokerage

17. 5 pts

A buyer's written agreement sets her broker's fee at 2.5% of the price in this example. She buys a $400,000 home, and the seller agrees to a concession of $7,000 toward the fee. If no other source pays, the buyer owes her broker:

A. $3,000

B. $10,000

C. $7,000

D. $0

18. 5 pts

A seller's agent knows the house's septic system fails every winter. The listing is in July, and the house is offered "as is." The agent must:

A. Say nothing, because the sale is as is

B. Disclose the defect to buyers, because it is a known material latent defect

C. Disclose it only if the buyer asks about the septic system

D. Keep it confidential for the seller

19. 5 pts

Under the federal lead-based paint rule, a buyer of a home built in 1965 must be given:

A. A free lead inspection paid by the seller

B. Removal of all lead-based paint before closing

C. A 30-day right to rescind after closing

D. A 10-day opportunity to test, which may be changed or waived in writing

20. 5 pts

A licensee showing a home notices a fresh patch of paint on one ceiling and a musty odor in the basement. The seller says there are no problems. The licensee should:

A. Disclose what was observed and recommend a professional inspection

B. Repaint the patch so it matches

C. Assure the buyer the house is sound, as the seller said

D. Say nothing, because the seller completed the disclosure form

ANSWER KEY

1. C. A listing broker is authorized for one specific transaction and generally cannot bind the seller — a special agent. A property manager is the classic general agent.
2. A. Compensation does not determine agency; the buyer representation agreement does. The broker owes fiduciary duties to the buyer.
3. D. Expiration ends an agency by the terms the parties set — an act of the parties. Death, destruction and bankruptcy end it by operation of law.
4. B. Accepting the benefits of an unauthorized act approves it after the fact — ratification. Estoppel arises when a principal leads a third party to believe someone is his agent.
5. D. The seller's financial situation and urgency are confidential information the agent must protect from the other side. It is also disloyal.
6. A. Obedience covers lawful instructions only. Refusing to show because of national origin violates the Fair Housing Act; the agent must refuse and withdraw if the seller insists.
7. C. An exaggerated opinion that a reasonable buyer would not take as fact is puffing, generally not actionable. Misrepresentation concerns false statements of fact.
8. A. Placing her own interest above the client's and concealing her relationship to the buyer is a breach of loyalty (and disclosure); the resale gain is a secret profit.
9. D. In an exclusive-agency listing the owner reserves the right to sell himself without a commission. Under an exclusive right to sell, A would be owed the full commission.
10. B. Total $\$350{,}000 \times 0.06 = \$21{,}000$; firm share \$10,500; agent $\$10{,}500 \times 0.60 = \$6{,}300$. D takes 60% of the whole commission.
11. A. A net listing creates a conflict of interest — the broker profits from an underpriced net — so many states ban or discourage it.
12. C. Commissions are always negotiable between the brokerage and its client. Any rate set by a commission, MLS or association would be illegal price fixing.
13. B. The sale occurred within the protection period, to a buyer the broker introduced, and the seller had not relisted with another broker.
14. D. A written buyer agreement is required before touring, and offers of compensation are not published on the MLS. Commissions remain negotiable

and are not set by any MLS.

15. B. A dual agent must stay neutral and protect each party's confidential price and motivation, but must still disclose known material defects.
16. C. In designated agency, each appointed licensee represents his own client fully; where permitted, it requires the disclosures and consents the state prescribes.
17. A. Fee $\$400{,}000 \times 0.025 = \$10{,}000$; minus the $7,000 concession leaves $3,000, unless the agreement provides otherwise.
18. B. Known material latent defects must be disclosed even by the seller's agent; an "as is" clause does not excuse concealment, and confidentiality never covers defects.
19. D. The rule requires disclosure of known lead paint, records, the EPA pamphlet, a warning statement and a 10-day testing opportunity for buyers. It does not require testing or removal by the seller.
20. A. Red flags call for disclosure of what the licensee observed and a recommendation of a professional inspection. Vouching for the house invites liability for what the licensee should have known.

PORTFOLIO PIECE: MY PATHWAY FILE — THE AGENCY PAGES

Assemble the agency and disclosure section of your Pathway File: the Relationship Map with its four diagrams and your state's agency-disclosure note (8.1); the OLD CAR Casebook with twelve solved cases and your "How I Will Practice" statement (8.2); the Listing Desk with its four listings, commission calculator and protection-clause checker (8.3); the Relationship Disclosure Packet with your state's pamphlet summary, the pretend buyer-agreement summary, the fee worksheet and the dual-agency script (8.4); and the Disclosure Walk-Through with its patent and latent list, red flags, lead-paint checklist and stigmatized-property note (8.5).

Close the section with a one-page letter to a pretend first client, written in your own voice, explaining whom you will represent, what you will owe them under OLD CAR, how you are paid and that the fee is negotiable, what you will never keep secret about a property, and why you will tell them the truth about a house even when it costs you a sale. Quote Proverbs 12:22. Date every page; Unit 9 builds on these artifacts with fair housing, advertising and the practice of a brokerage.

LOOK FOR	WHAT IT MEANS
Relationship Map	Every person in all four transactions is correctly labeled client, customer or agent; each agent is classified universal, general or special with the method of creation; and the state disclosure rule is cited and dated.
OLD CAR Casebook	All twelve cases name the right duty and give a workable correct response; the customer cases distinguish puffing from misrepresentation; the practice statement is honest and specific.
Listing Desk	Each listing story pays the right broker; the calculator reproduces $24,000, $12,000 and $8,400 with every rate labeled an example; the protection-clause checker handles relisting correctly.
Relationship Disclosure Packet	The state's relationships are explained accurately in plain language; the buyer agreement summary states compensation, the cap and that fees are negotiable; the worksheet returns $2,100 and $10,500; the script obtains informed written consent.
Disclosure Walk-Through	Patent and latent items are correctly classified, each red flag is paired with the right professional, and the lead-paint checklist and stigmatized-property note are accurate, cited and dated, with private family details kept out of shared copies.

LOOK FOR	WHAT IT MEANS
Letter to a first client	Written in the student's own voice, it explains representation, the fiduciary duties, negotiable compensation and the duty to disclose defects accurately, and connects Proverbs 12:22 to honest dealing without canned language.

8.1 What Agency Is: Principals, Agents and Customers

OBJECTIVES

- Define principal (client), agent, customer and third party, and identify each in a transaction.
- Classify universal, general and special agents and place listing brokers, buyer's agents, property managers and salespeople in the right category.
- Explain how agency is created — by express agreement, implication, ratification and estoppel — and why compensation does not determine agency.
- Describe subagency, the 1983 FTC findings that changed it, and the rise of buyer agency.
- List the ways agency terminates by acts of the parties and by operation of law, and explain agency coupled with an interest and the limits of a power of attorney.

> **Warm-up.** You ask your older cousin to sell your bicycle for you at a garage sale and promise her $10 if it sells. A neighbor walks up, and your cousin says, "Between us, he'd take $40 instead of $60." In five minutes, write down who your cousin is working for, whether she did anything wrong, and why. You have just described the law of agency.

WATCH

Creating Agency Relationships | Real Estate Exam Prep

PrepAgent · 7:19

https://www.youtube.com/watch?v=0JiSy4Hdc9A

> **WHEN TO WATCH**
> Watch after core idea four; pause at each method of creating agency (express, implied, ratification, estoppel) and write a one-line real estate example of your own before the video gives one.

BACKUP VIDEO

Real Estate Exam Prep: Who Does the Agent Represent?

Real Estate Exam Prep: Freehold · 16:01

https://www.youtube.com/watch?v=gMU0Lvtyk6E

Twelve scenario cases on agency and duties; watch before the practice set, pause at each case and write your answer and the reason before the explanation appears.

KEY TERMS

agency

A fiduciary relationship in which one person, the agent, is authorized to act on behalf of another, the principal, in dealings with third parties.

agent

The person authorized to act for the principal; in real estate, the brokerage firm is the agent, acting through its licensees.

principal (client)

The person who hires an agent and to whom the agent owes fiduciary duties.

customer (third party)

A party to the transaction who is not represented by the agent and is owed honesty, fair dealing and disclosure of known material defects, but not fiduciary loyalty.

universal agent

An agent authorized to do everything the principal could lawfully delegate, usually through a general power of attorney.

general agent

An agent authorized to perform a range of acts in a particular business or area, such as a property manager or a salesperson acting for a broker.

special agent

An agent authorized to perform one specific act or transaction, such as a listing broker or a buyer's broker.

subagent

An agent of an agent — historically a cooperating broker who, through the MLS, worked with a buyer but owed fiduciary duties to the seller.

ratification

The creation of agency after the fact, when a principal accepts the benefits of or approves acts performed without prior authority.

agency by estoppel (ostensible agency)

Agency created when a principal's words or conduct lead a third party reasonably to believe that someone is the principal's agent, so the principal may not deny it.

agency coupled with an interest

An agency in which the agent has an interest in the property itself; it cannot be revoked by the principal and does not end at the principal's death.

power of attorney

A written instrument authorizing an attorney-in-fact to act for the principal, generally or for specific acts; a durable power survives the principal's incapacity but not death.

CORE IDEAS

The story. In 1983 the staff of the Federal Trade Commission published a long report on the residential real estate brokerage industry. Its most quoted finding came from a survey of home buyers. In a typical sale of that era, a buyer called a broker, toured homes in that broker's car and signed an offer the broker wrote — yet under the rules of most multiple listing services, that broker was legally a **subagent** of the *seller*, owing the seller loyalty, obedience and confidentiality. The buyers did not know it. According to the survey as it is commonly reported, about 72 percent of buyers in sales involving a cooperating broker believed that broker was representing *them*. Many had told "their" agent the most they would pay — information the agent was

duty-bound to pass to the seller. The report did not accuse brokers of lying. It showed that an entire industry's customers misunderstood whom the agent worked for, and it set off two decades of change in every state: agency disclosure laws, written agency agreements, and a new figure in the market — the **buyer's agent**.

How they figured it out. States responded first with **agency disclosure** laws, beginning in the mid-1980s: before a buyer or seller revealed confidential information or signed an offer, the licensee had to explain, often on a state form, whom the licensee represented. Disclosure exposed the problem plainly, and buyers began to ask for representation of their own. Buyer agency spread through the late 1980s and 1990s, and in the early 1990s the national Realtor association's MLS policy made the old blanket offer of subagency optional, so cooperating brokers could represent buyers while still sharing listings. Brokers who now represented both sellers and buyers had to face **dual agency** — the subject of Lesson 8.4 — and many states added new categories such as designated agency and transaction brokerage. Underneath all the change, the old law of agency did not move at all. It still asks the questions this lesson teaches: who is the principal, who is the agent, how was the agency created, how far does the agent's authority reach, and when does it end?

The big idea. Agency is a fiduciary relationship: the **agent** is authorized to act for the **principal** in dealings with others, and owes the principal the highest duties of trust (Lesson 8.2). In real estate the principal is called the **client**, and the agent is the **brokerage firm** — the client's contract is with the broker, and the salespeople or associate brokers who do the work act as the broker's agents. Anyone in the transaction who is not represented is a **customer** or **third party**: owed honesty, fair dealing and disclosure of known material defects, but not loyalty or confidentiality. Agents are classified by the breadth of their authority. A **universal agent** may do anything the principal could lawfully delegate, usually under a general power of attorney. A **general agent** has broad authority over a range of matters in one business — a property manager running a building, or a salesperson acting for the employing broker. A **special agent** is authorized for one specific transaction: a listing broker, hired to find a buyer, is a special agent who generally cannot sign contracts or bind the seller; a buyer's broker is likewise a special agent.

Agency can be created four ways. By **express agreement**, oral or written — a listing agreement or a buyer representation agreement; most states require these to be in writing for the broker to enforce a commission. By **implication** from conduct — a

licensee who acts as if representing a buyer, giving advice and negotiating, may create an implied agency, with all its duties, without meaning to. By **ratification** — a principal who accepts the benefits of an unauthorized act, such as an offer the broker negotiated without authority, approves it after the fact. And by **estoppel** (ostensible or apparent agency) — a principal whose words or conduct lead a third party reasonably to believe someone is his agent cannot later deny the agency to that third party's harm. One rule settles countless exam questions: **compensation does not determine agency**. Who pays the broker does not decide whom the broker represents; the agreement and conduct do. A listing broker could historically pay a buyer's broker from the seller's commission without making that broker the seller's agent.

Agency ends in two families of ways. By **acts of the parties**: **performance** (the house sells and closes), **expiration** of the agreed term, **mutual agreement**, **revocation** by the principal, or **renunciation** by the agent. Either side has the *power* to end the agency at any time, but not always the *right*: a seller who revokes an exclusive listing without cause may owe the broker damages, such as expenses or the commission, and an agent who abandons a client may be liable too. By **operation of law**: the **death** or **incapacity** of either principal or broker, **destruction** or condemnation of the property, **bankruptcy** of either party, or loss of the broker's license. Notice the contrast with Lesson 7.2: a purchase agreement survives a party's death, but an agency — a personal relationship of trust — does not. The exception is an **agency coupled with an interest**, where the agent holds an interest in the property itself, as when a broker who advanced money for a development is given the right to sell its lots; that agency cannot be revoked by the principal and does not end at the principal's death.

A **power of attorney** is the written instrument that creates many agencies outside real estate brokerage. The principal appoints an **attorney-in-fact** — who need not be a lawyer — with a **general** power to handle all the principal's affairs (a universal agency) or a **special** or limited power for one act, such as signing the deed at a closing the seller cannot attend. Its limits are tested: a power of attorney used to convey real estate is commonly recorded with the deed; it ends at the principal's death; and a **durable** power of attorney survives the principal's incapacity but still ends at death. An attorney-in-fact owes the principal fiduciary duties and may not use the power for his own benefit — a son with his mother's power of attorney may

not deed her house to himself. A real estate licensee is not an attorney-in-fact merely by holding a listing; a listing gives the broker authority to market and to find a buyer, not to sign the seller's name. Finally, remember that a property manager is the classic general agent, while a listing broker or buyer's broker is the classic special agent.

On the exam today. Agency is one of the heaviest sections of the national exam, and this lesson supplies its vocabulary. Expect "A listing broker is what kind of agent?" — special. "A property manager?" — general. "A person with a general power of attorney?" — universal. Expect scenarios on creation: a broker acts without authority and the seller accepts the result — ratification; a seller lets a neighbor show his house and act as his agent, and a buyer relies on it — estoppel. The traps: thinking the party who pays the commission is the client (compensation does not determine agency); thinking the salesperson, rather than the brokerage, holds the client relationship; thinking a seller cannot revoke a listing (he has the power, though perhaps not the right); and forgetting that death or incapacity of either party ends an agency, while it does not end a purchase agreement. When a stem asks whom the agent owes fiduciary duties, find the principal; everyone else is a customer owed honesty and fairness.

PICTURE STUDY



Joseph, Overseer of Pharaoh's Granaries, Lawrence Alma-Tadema, 1874 · Oil on panel · Dahesh Museum of Art, New York

Image: Wikimedia Commons, public domain

Lawrence Alma-Tadema, a Dutch-born painter who settled in London and became one of the most famous artists of the Victorian age, built his career on painstakingly researched scenes of the ancient world. In 1874 he painted Joseph — sold into Egypt as a slave, then raised by Pharaoh to rule over all the land — seated as overseer of the granaries while a scribe reads him the accounts. Joseph is one of history's great agents: he acted for Pharaoh, with Pharaoh's authority, over Pharaoh's whole kingdom. He opens this lesson because the questions of agency are as old as Genesis: who is the principal, how far does the agent's authority reach, and to whom must he account?

Look closely

- Find the staff in Joseph's hand. It is a sign of delegated authority — power that belongs to Pharaoh but is exercised by his agent.
- Look at the scribe unrolling the papyrus. An agent who handles another's goods must keep records and account for every measure — one of the fiduciary duties you will learn next.
- Notice the grain heaped on the mat in the foreground: the property itself, held and managed for the principal, not owned by the agent.

- Study the hieroglyphs and lotus patterns on the chair and walls. Alma-Tadema copied such details from real Egyptian objects so the setting would be as true as he could make it — the care an agent owes the facts.

Talk about it

1. Was Joseph a universal, general or special agent of Pharaoh? Use Genesis 41:40 to defend your answer.
2. What would Joseph have owed Pharaoh as his agent, and what would he have owed the hungry people of Egypt and Canaan who came to buy grain from him?
3. Joseph was given great power over another man's property and never used it for himself. What made him trustworthy — and how does a young licensee earn that kind of trust?

PROJECT

The Relationship Map

Every transaction has a cast: principals, agents, subagents, customers and third parties. A licensee who cannot name, at every moment, whom he represents will sooner or later breach a duty without meaning to. In this project you will draw relationship maps for four pretend transactions, label every person, and write the duties each is owed — the same exercise a careful broker does in his head before every first conversation.

You will need

- Exam notebook, ruler and colored pencils (or a free drawing tool)
- This lesson's key terms
- Your state real estate commission's agency disclosure form or pamphlet, found on the commission's official site

Steps

1. Choose four pretend transactions: (1) a seller with a listing broker and an unrepresented buyer; (2) a seller with a listing broker and a buyer with a buyer's broker at another firm; (3) an apartment owner with a property manager and a tenant; (4) an elderly seller whose daughter holds a power of attorney.
2. For each, draw every person as a box and connect them with arrows: a solid arrow for an agency relationship (principal → agent) and a dotted line for a customer relationship.
3. Label each agent universal, general or special, and write beside each arrow how the agency was created (express written agreement, implied, ratification, estoppel).
4. Under each map, list the duties owed: fiduciary duties to the principal; honesty, fair dealing and disclosure of known material defects to each customer.
5. Add a line under each map naming two events that would terminate the agency by operation of law.

6. Find your state's agency disclosure form or pamphlet and write down when it must be given and to whom. Date the note.
7. Title the page "Relationship Map," date it and add it to your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, with universal, general and special agent on one card, each with a real estate example.
2. Draw a two-branch tree titled "How agency ends": ACTS OF THE PARTIES (performance, expiration, mutual agreement, revocation, renunciation) and OPERATION OF LAW (death, incapacity, destruction, condemnation, bankruptcy, loss of license).
3. Write a trap list titled "Agency basics": compensation does not determine agency; the client belongs to the broker; listing broker = special agent; property manager = general agent; death ends agency but not a sales contract; durable POA survives incapacity, not death.

> **From history.** The English word "agent" comes from the Latin *agere*, "to do" — an agent is one who does for another. Roman law already had the idea: a *mandatum* was an unpaid commission to act for a friend, and the agent who took it on was bound to perform it faithfully. The medieval English law merchant then developed the factor, a merchant's agent abroad who held and sold goods for distant owners; much of today's law of agency — duties of loyalty, accounting and obedience — was worked out in lawsuits between merchants and their factors.

Example 1. Exam style. A seller signs an exclusive listing with a brokerage. The listing salesperson shows the house to a buyer who has no agent. Which statement is correct?

A. The buyer is the brokerage's client because the brokerage is showing him homes

B. The salesperson is the seller's agent, and the brokerage has no duties

C. The seller is the brokerage's client; the buyer is a customer owed honesty and fair dealing

D. The buyer is a client because he will pay part of the commission at closing

Show solution

1. Find the agency agreement: the seller signed the listing with the *brokerage*, so the seller is the principal (client) and the brokerage is the agent.
2. The salesperson acts for the brokerage; the client relationship belongs to the firm, so B is wrong.
3. The buyer has no agreement and no implied agency here, so he is a customer — owed honesty, fair dealing and disclosure of known material defects.
4. Who pays at closing does not determine agency, which defeats D.

Answer: C. The seller is the client of the brokerage; the unrepresented buyer is a customer.

Example 2. Classify each as universal, general or special agent: (a) a property manager who collects rents, hires repairmen and signs leases for an apartment owner; (b) a broker hired under a listing to find a buyer for one house; (c) a daughter holding her father's general power of attorney while he is abroad; (d) a salesperson licensed under a broker.

Show solution

1. (a) Broad, continuing authority over a range of matters in one business: **general agent.**
2. (b) Authority for one transaction, without power to bind the seller to a contract: **special agent.**
3. (c) Authority over all of the principal's affairs that may be delegated: **universal agent.**
4. (d) The salesperson performs many acts for the broker across many transactions: a **general agent** of the broker.

Answer: (a) general; (b) special; (c) universal; (d) general agent of the broker.

Example 3. A broker, without any listing, finds a buyer for a vacant lot and brings the owner a signed $90,000 offer. The owner signs the purchase agreement and, at closing, signs a settlement statement showing a $5,400 commission to the broker. Later the owner refuses to pay, saying he never hired the broker. Separately, the owner's brother had for years told neighbors he handled the owner's properties, with the owner's knowledge, and a buyer relied on the brother's promises. Which methods of creating agency apply?

Show solution

1. First facts: the broker acted without authority, but the owner accepted the benefit and approved the commission at closing — **ratification**.
2. Whether a commission is enforceable also depends on the state's writing requirement; the signed settlement statement may help satisfy it. Many states require a written agency agreement before a broker can sue, so the safe practice is always a written agreement first.
3. Second facts: the owner allowed his brother to appear as his agent, and a third party reasonably relied — **agency by estoppel**.
4. Neither involved an express agreement in advance.

Answer: The broker's agency arose by ratification; the brother's by estoppel. Collecting the commission may still depend on the state's writing rule.

PRACTICE

1. Easy Define principal, agent and customer in one sentence each.

   Show answer

   The principal (client) hires the agent and is owed fiduciary duties; the agent is authorized to act for the principal; the customer is an unrepresented party owed honesty, fair dealing and disclosure of known material defects, but not loyalty.

2. Easy What kind of agent is a listing broker, and why?

   Show answer

   A special agent, because he is authorized for one specific transaction — finding a buyer for one property — and generally cannot bind the seller to a contract.

3. **Easy** Name the four ways an agency relationship can be created.

Show answer

Express agreement (written or oral), implication from conduct, ratification after the fact, and estoppel (ostensible agency).

4. **Medium** A buyer's broker is paid from the listing broker's commission at closing. Does that make the buyer's broker the seller's agent?

Show answer

No. Compensation does not determine agency; the buyer's representation agreement and the broker's conduct do. The buyer's broker owes fiduciary duties to the buyer.

5. **Medium** A salesperson leaves her brokerage and wants to take her listings with her. May she?

Show answer

Not on her own. Listings are contracts between the client and the brokerage, not the salesperson, so they stay with the broker unless the broker and client agree otherwise.

6. **Medium** A seller dies two weeks into a six-month listing. What happens to the listing, and why does that differ from what happens to a signed purchase agreement?

Show answer

The listing terminates by operation of law, because agency is a personal relationship that ends at the death of either party. A purchase agreement, by contrast, binds the seller's estate, which must complete the sale.

7. **Medium** What did the 1983 FTC staff survey reveal about subagency, and what changes followed?

Show answer

That most buyers in co-op sales — about 72 percent, as commonly reported — believed the cooperating broker represented them, when that broker was legally the seller's subagent. States adopted agency disclosure laws, buyer agency grew, and MLS subagency offers became optional.

8. Hard A seller revokes an exclusive-right-to-sell listing after three months of a six-month term because he “changed his mind,” and the broker had done nothing wrong. Was the revocation effective, and what may the broker recover?

Show answer

It was effective — a principal has the power to end an agency at any time — but not rightful, because the listing ran six months. The broker may sue for damages, typically expenses and possibly the lost commission, depending on the contract and state law.

9. Hard A developer borrows $200,000 from a broker and gives her the exclusive right to sell the subdivision’s lots, with sale proceeds repaying the loan. The developer dies. Does the broker’s authority end?

Show answer

No. This is an agency coupled with an interest — the broker has a financial interest in the property itself — so it cannot be revoked by the principal and does not end at the principal’s death.

10. Hard A woman holds her elderly father’s durable power of attorney. He suffers a stroke and is incapacitated; later he dies. Explain what happens to her authority at each event, and whether she may deed his house to herself as a gift.

Show answer

Her durable power survives his incapacity, so she may keep acting for him; it ends at his death, when the estate’s personal representative takes over. As attorney-in-fact she is a fiduciary and may not use the power to benefit herself, such as gifting herself the house, unless the instrument expressly and lawfully allows it.

11. **Challenge** A licensee hosts an open house for her seller-client. A visitor says, "I don't have an agent — can you help me write an offer and tell me what to offer?" She drafts the offer on the approved form and advises him to offer $15,000 under list. What agency issue has she created?

    Show answer

    By advising the buyer on price and negotiating for him, she may have created an implied agency with the buyer while already representing the seller — an undisclosed dual agency. She should have disclosed whom she represents at the first substantive contact and either treated him as a customer or followed her state's procedure for consented dual or designated agency.

12. **Challenge** Explain in three sentences why "compensation does not determine agency" was especially important under the old MLS subagency system.

    Show answer

    Under subagency, the cooperating broker who worked with the buyer was paid from the seller's commission and legally owed loyalty to the seller. Buyers assumed that the agent who drove them around worked for them, but the source of payment and the MLS offer of subagency put the agent on the seller's side. The rule reminds licensees and consumers alike that the agreement and the conduct, not the check, decide whom an agent represents.

COMMON MISTAKES

- Assuming the party who pays the commission is the client. Compensation does not determine agency.
- Thinking the salesperson personally holds the listing. The client's contract is with the brokerage.
- Calling a listing broker a general agent. A listing broker is a special agent; a property manager is the classic general agent.
- Believing a principal cannot revoke an agency. He has the power at any time, though he may owe damages if he lacks the right.
- Forgetting that agency ends at the death or incapacity of either party, unlike a purchase agreement.
- Thinking a durable power of attorney survives death. It survives incapacity only.

Make it a game · Who's My Client?. One player is the narrator; everyone else is a licensee. The narrator describes a scene in two sentences — "A seller lists with Broker A; Broker B shows the house to a buyer who signed nothing" — and then points to a character and asks, "Client, customer, or agent?" The first correct shout scores a point; naming the kind of agent (universal, general, special) or how the agency was created scores a bonus. Twist cards change the scene mid-play: "The seller dies," "The buyer signs a representation agreement," "The seller ratifies an offer." After ten scenes, the high scorer narrates the next round, and the low scorer recites the ways agency ends.

Scripture. "Thou shalt be over my house, and according unto thy word shall all my people be ruled: only in the throne will I be greater than thou." (Genesis 41:40, KJV)

Pharaoh gives Joseph authority over his whole house — about as broad an agency as can be imagined — yet keeps the throne for himself. Every agency has that shape: real authority, real limits, and a principal whose interests come first. Joseph's faithfulness in another man's house is the pattern for every licensee who acts in a client's name.

8.2 The Fiduciary Duties

OBJECTIVES

- Name and apply the fiduciary duties an agent owes a client — obedience, loyalty, disclosure, confidentiality, accounting, and reasonable care and skill (OLD CAR).
- Distinguish the duties owed to a client from the duties of honesty, fair dealing and disclosure of known material defects owed to customers.
- Distinguish puffing, negligent misrepresentation, intentional misrepresentation and fraud, and identify latent defects that must be disclosed.
- Explain the licensee's duty to disclose a personal interest, and why secret profits and kickbacks are forbidden.
- Analyze transaction scenarios step by step to decide which duty is involved and what the licensee must do.

> **Warm-up.** Your client, a seller, tells you, "I'll take $20,000 less if I have to — but don't tell anyone." Ten minutes later a buyer's agent calls and asks, "Is there any room on price?" In five minutes, write the exact sentence you would say, and then write one sentence explaining whose interest your answer protects.

WATCH

Agency Relationships: Fiduciary Duties | Real Estate Prep Exam Videos

The Real Estate Classroom · 13:36

https://www.youtube.com/watch?v=YoMzFO_cKWA

> **WHEN TO WATCH**
> Watch after the big idea; as he writes each duty on the whiteboard, add his example to your notebook, then write a second example of your own from a home sale.

BACKUP VIDEO

What are the Fiduciary Duties of a Real Estate Agent?

US Realty Training · 9:28

https://www.youtube.com/watch?v=4L0qvq5es98

Watch before the project as a second pass through OLD CAR; for each duty he names, write one breach you would expect to see on an exam.

KEY TERMS

fiduciary

A person in a position of trust and confidence who must act in another's best interest; a real estate agent is a fiduciary of the client.

loyalty

The duty to place the client's interests above everyone else's, including the agent's own; it forbids secret profits and undisclosed self-dealing.

confidentiality

The duty to keep the client's private information — motivation, finances, bottom price — secret, during and after the agency.

reasonable care and skill

The duty to perform with the competence expected of a licensee, and to refer clients to other experts for matters beyond the agent's expertise.

misrepresentation

A false statement or concealment of a material fact; negligent if made carelessly, intentional if made knowingly.

obedience

The duty to follow the client's lawful instructions; an agent must refuse unlawful or unethical instructions, such as to discriminate or conceal a defect.

disclosure

The duty to tell the client all material facts the agent knows or should know that could affect the client's decisions.

accounting

The duty to safeguard and account for all money and property entrusted to the agent, including earnest money held in trust.

puffing

Exaggerated opinion or sales talk, such as "a gorgeous view," that a reasonable buyer would not take as a statement of fact; generally not actionable.

fraud

An intentional misrepresentation or concealment of a material fact, made to induce another to act, on which that person reasonably relies to his harm.

latent defect

A hidden defect that would not be discovered by an ordinary, reasonable inspection, such as a cracked foundation under carpet.

secret profit

Any undisclosed financial gain an agent makes from the agency, such as buying through a relative and reselling, or taking a kickback from a vendor.

CORE IDEAS

The story. In 1902 Walter Salmon leased the Hotel Bristol at Fifth Avenue and 42nd Street in New York for twenty years, planning to rebuild it into shops and offices. He needed money, and Morton Meinhard supplied half of it. They became joint venturers: Salmon managed the property; Meinhard shared the profits and losses. Twenty years passed. With only a few months left on the lease, the landowner, Elbridge Gerry, who now owned the whole surrounding block, approached Salmon — and only Salmon — with a far larger opportunity: a new lease of the entire tract for a major redevelopment. On January 25, 1922, Salmon signed it through his own company. He never told Meinhard. When Meinhard learned of it a month later and demanded a share, Salmon refused, and Meinhard sued. In 1928 the case reached New York's highest court, and Judge Benjamin Cardozo — whom you met in Lesson 7.2 — wrote one of the most quoted sentences in American law: a fiduciary "is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." Meinhard won roughly half the new lease.

How they figured it out. Salmon had not lied to Meinhard. His defense was that he had simply said nothing about an opportunity that came to him. Cardozo answered that silence was itself the breach. Salmon held his position because of the venture; the opportunity came to him because of that position; and a man who manages property for another may not quietly divert to himself what belongs, in fairness, to both. Courts had long applied the same reasoning to trustees, guardians and agents of every kind, and real estate brokerage absorbed it whole. A broker is a **fiduciary**: once a client places trust in him, the ordinary rules of arm's-length bargaining no longer apply between them. He may not compete with the client, profit secretly from the client's business, or keep from the client what the client would want to know. State license laws now write these duties into statute, the professional codes of ethics repeat them, and the national exam tests them through a single memory word that every licensee learns: **OLD CAR**.

The big idea. An agent owes the client six fiduciary duties. **Obedience**: follow the client's lawful instructions — but never an unlawful one, such as refusing to show to a family because of their religion, or hiding a known defect. **Loyalty**: put the client's interests first, above the agent's own and above everyone else's; no secret profits, no undisclosed self-dealing. **Disclosure**: tell the client every material fact the agent knows or reasonably should know — the buyer's eagerness, a better offer coming, a defect, a zoning change, the agent's own relationship to the other party. **Confidentiality**: keep the client's private information private — the seller's bottom price, the buyer's top price, a pending divorce, a job transfer — and keep it private even after the agency ends. **Accounting**: safeguard every dollar and document entrusted, keep earnest money in the trust account, never commingle or convert, and report all money handled. **Reasonable care and skill**: perform competently, price with sound data, check facts, and refer the client to attorneys, inspectors, surveyors and tax advisers for matters beyond a licensee's expertise.

Customers are owed a different, shorter list. A seller's agent does not owe the buyer-customer loyalty or confidentiality — he may not tell the buyer the seller's lowest price — but he does owe honesty and fair dealing, reasonable care in what he says, and disclosure of known **material defects**. A **material fact** is one that a reasonable person would consider important to the decision: price-affecting defects, legal problems with title, a planned highway next door. A **latent defect** is hidden and would not be found on ordinary inspection — a cracked slab under carpet, a buried oil tank. A **patent defect** is visible on reasonable inspection. In nearly every state, a licensee who knows of a latent material defect must disclose it to the buyer even though the licensee represents the seller, and must refuse a seller's instruction to hide it. The duty to the client and the duty to the customer do not conflict here: obedience never requires a lie, and confidentiality protects the seller's motives and price, never a defect in the house.

Words can create liability, and the exam grades them on a scale. **Puffing** is exaggerated opinion — "the best view in town," "a charming kitchen" — that no reasonable buyer would treat as fact; it is generally not actionable, though wise licensees keep it modest. A **misrepresentation** is a false statement of a material fact. It is **negligent** when the licensee should have known better ("The roof is five years old," repeated from memory without checking) and **intentional** when he knows it is false. **Fraud** is an intentional misrepresentation or concealment of a material fact,

made to induce the other party to act, on which that party reasonably relies to his harm; it can unwind the contract, support damages (sometimes punitive) and cost the licensee his license. Silence can be fraud too: covering a water stain with fresh paint and saying nothing is **active concealment**. And a licensee is responsible for what he "should have known": a reasonable licensee notices obvious red flags and investigates or recommends inspection rather than vouching for what he has not checked.

Two loyalty rules come up constantly. First, a licensee who buys, sells or leases property for himself, a relative or a business he owns must disclose in writing that he is licensed and that he has an interest in the deal. An agent who quietly buys a client's listing through a friend, intending to resell it at a profit, commits the classic breach — a **secret profit** — and may forfeit his commission, owe the client the profit and lose his license. Second, a licensee may not accept any fee, gift or **kickback** from another party or vendor without the client's informed consent, and under the federal Real Estate Settlement Procedures Act, kickbacks and unearned fees for referring settlement business — to a lender, title company or inspector — are prohibited outright. The confidentiality duty also survives the agency: after a listing ends, the former agent may not use what he learned about the seller's finances to help a later buyer. But disclosure and confidentiality have limits on both sides: a licensee may never keep confidential a known material defect, and may never disclose the client's confidences to win a deal.

On the exam today. Fiduciary duties are among the most heavily tested topics on the national exam, almost always as scenarios. Ask yourself first: is this person a client or a customer? Then match the conduct to a duty. A seller's agent telling a buyer "the seller will take less" breaches *confidentiality* (and loyalty). An agent who fails to tell the seller that the buyer has said he will pay more breaches *disclosure*. Depositing earnest money in the agent's personal account breaches *accounting*. Following a seller's instruction not to show to a protected class violates fair housing — *obedience* covers lawful instructions only. Mispricing a home without checking comparables breaches *reasonable care*. The traps: thinking confidentiality lets an agent hide a known defect (it never does); thinking the seller's agent owes the buyer nothing (he owes honesty and disclosure of known material defects); calling "stunning sunsets" misrepresentation (it is puffing); and forgetting that confidentiality continues after the agency ends.

PICTURE STUDY



Rebecca and Eliezer, Bartolomé Esteban Murillo, c. 1650 · Oil on canvas · Museo del Prado, Madrid

Image: Wikimedia Commons, public domain

Bartolomé Esteban Murillo of Seville, the best-loved Spanish painter of his century, often set biblical stories in the warm light of everyday life. Here he paints Genesis 24: Abraham's old servant — traditionally named Eliezer — has traveled to Mesopotamia under oath to find a wife for his master's son, and at the well Rebekah offers water to him and his camels. Few stories in Scripture describe a more faithful agent. He swears to follow his master's instructions, prays for success on his master's behalf, carries his master's goods and gives an exact account of them, and refuses even to eat until he has told his errand. He opens this lesson because every fiduciary duty is visible in him.

Look closely

- Find the camels resting in the distance. They belong to Abraham, not to the servant; he is entrusted with another man's property — the root of the duty of accounting.
- Look at how the servant bends to drink, travel-worn and plainly dressed. Murillo shows a man on someone else's business, not his own.
- Study Rebekah's steady gesture with the pitcher. The servant had asked God for exactly this sign — a woman who would offer water to him and his camels.

- Notice the other young women watching from the well. Murillo puts witnesses in the scene, as the story itself is full of careful reports and testimony.

Talk about it

1. Which fiduciary duties can you find in Genesis 24 — obedience, loyalty, disclosure, confidentiality, accounting, care? Give a verse or event for each one you find.
2. The servant tells Laban's household the whole story before eating. Why might a faithful agent insist on disclosing his errand first?
3. Cardozo said a fiduciary must hold to "the punctilio of an honor the most sensitive." Where do you see that kind of honor in Abraham's servant, and where could you practice it this week?

PROJECT

The OLD CAR Casebook

Brokers train new licensees with "what would you do?" cases, because fiduciary breaches rarely announce themselves. In this project you will write twelve one-paragraph pretend cases — two for each duty of OLD CAR — and solve each one: the duty involved, whether it was breached, what the licensee should have said or done, and the likely consequence. Then you will write a one-page statement of how you intend to practice.

You will need

- Exam notebook or a free word processor
- This lesson's key terms and worked examples
- Your state real estate commission's license law or rules on agency duties (search the commission's official site for "duties of a licensee")

Steps

1. Make a six-section page, one section for each duty: Obedience, Loyalty, Disclosure, Confidentiality, Accounting, Reasonable Care.
2. In each section, write two short pretend cases: one where the licensee keeps the duty under pressure, and one where a licensee breaches it.
3. For each breach, write the solution in four lines: the duty, the breach, what should have been said or done, and the likely consequence (commission, civil liability, license discipline).
4. Add a seventh section, "Customers," with two cases on puffing versus misrepresentation and on a latent defect that must be disclosed to a buyer.
5. Look up your state's statutory list of licensee duties and note any duty or wording that differs from OLD CAR. Record the citation and date.
6. Write a one-page "How I Will Practice" statement in your own words, naming the duty you expect to find hardest to keep and how you will keep it.
7. Title the file "OLD CAR Casebook," date it and add it to your Pathway File.

1. Make flashcards for every key term, with an OLD CAR card listing all six duties and one example of a breach for each on the back.
2. Draw a two-column chart: CLIENT IS OWED (the six duties) and CUSTOMER IS OWED (honesty, fair dealing, reasonable care, disclosure of known material defects).
3. Write a trap list titled "Duties": confidentiality never hides a defect; obedience covers lawful instructions only; puffing ≠ misrepresentation; disclose your own interest in writing; no secret profits or kickbacks; confidentiality outlives the listing.

> **From history.** Cardozo's "punctilio" sentence has a rival for fame in the same field. In 1726 the English Court of Chancery decided *Keech v. Sandford*, in which a trustee holding a market lease for a child asked the landlord to renew it for the child; the landlord refused, so the trustee took the renewal for himself. The Lord Chancellor ordered him to hold it for the child anyway, though he had done nothing dishonest, because otherwise a trustee would always be tempted. That strict rule against fiduciaries profiting from their position still governs real estate agents today.

Example 1. Exam style. A listing agent knows the seller has been transferred and must sell within 30 days. A buyer's agent asks, "Why is the seller moving?" The listing agent replies, "He's been transferred and has to be out by the end of the month, so make an offer." Which duty has the listing agent breached?

A. Accounting
B. Confidentiality
C. Obedience
D. Reasonable care

Show solution

1. Identify the relationship: the seller is the listing agent's client; the buyer is not.
2. The seller's urgency is private information that weakens his negotiating position — classic confidential information.
3. Revealing it to the other side breaches confidentiality (and loyalty). Nothing involved money held in trust (A) or an instruction (C).
4. The honest, loyal answer would have been, "The seller has personal reasons for moving; I can't share them, but he'd welcome your offer."

Answer: B. The agent disclosed a client's confidential motivation to the other side.

Example 2. A seller tells his listing agent, “The basement floods every spring — but I painted over the stains. Don’t mention it.” A buyer asks the agent, “Any water problems?” Work through the agent’s duties step by step.

Show solution

1. Obedience: the agent must follow *lawful* instructions. An instruction to conceal a known material latent defect is not lawful, so it does not bind him.
2. Customer duty: the buyer is owed honesty and disclosure of known material defects. Seasonal flooding is material and, under fresh paint, latent.
3. Fraud risk: painting over the stains and staying silent is active concealment; answering “no” would be intentional misrepresentation.
4. Correct course: explain to the seller that the defect must be disclosed (on the state disclosure form and in answer to the buyer), and that if he refuses, the agent must withdraw rather than participate; recommend the seller consult an attorney.
5. Answer the buyer truthfully; recommend a professional inspection.

Answer: The agent must disclose the flooding to the buyer and may not follow the seller’s instruction; if the seller insists on concealment, the agent should withdraw from the listing.

Example 3. A licensee lists a house at $300,000. A day later her brother offers $285,000 through another brokerage; she says nothing about the relationship, the seller accepts, and three months later the brother resells for $340,000 and gives her half the profit. Identify every breach and the likely consequences.

Show solution

1. Loyalty: she placed her own and her brother's interest above the client's.
2. Disclosure: she failed to tell the seller of her relationship to the buyer, a material fact.
3. Secret profit: her share of the resale profit, $\frac{\$340{,}000 - \$285{,}000}{2} = \$27{,}500$, came from the agency without the client's knowledge.
4. Consequences commonly include forfeiture of her commission, liability to the seller for the secret profit and damages, possible rescission or other civil remedies, and license discipline.

Answer: Breaches of loyalty and disclosure, and an undisclosed secret profit of $27,500; she risks losing her commission, repaying the profit, civil liability and license discipline.

PRACTICE

1. Easy What does OLD CAR stand for?

   Show answer

   Obedience, Loyalty, Disclosure, Confidentiality, Accounting and Reasonable care and skill — the six fiduciary duties an agent owes the client.

2. Easy Is "this home has the most beautiful garden on the street" puffing or misrepresentation?

   Show answer

   Puffing — an exaggerated opinion a reasonable buyer would not treat as a statement of fact. It is generally not actionable.

3. Easy Which duty requires a broker to deposit earnest money in a trust account and keep records of it?

Show answer

Accounting — the duty to safeguard and account for all money and property entrusted to the agent.

4. Medium A seller instructs his agent not to show the home to families with children. What should the agent do, and which duty is NOT violated by refusing?

Show answer

Refuse, explain that familial status is protected under the Fair Housing Act, and withdraw if the seller insists. Refusing does not violate obedience, because obedience covers only lawful instructions.

5. Medium A buyer tells the listing agent, "I'd pay full price, but let's start lower." Must the listing agent tell the seller?

Show answer

Yes. The seller is the listing agent's client, and the duty of disclosure requires passing on every material fact, including the buyer's willingness to pay more. The buyer is a customer and is owed no confidentiality.

6. Medium A listing agent tells a buyer the roof is "about five years old" from memory; it is actually twenty. The buyer relies on it. What kind of misrepresentation is this?

Show answer

Negligent misrepresentation — a false statement of material fact made carelessly, without checking, by someone who should have known better. If the agent knew it was false, it would be intentional, and could be fraud.

7. Medium A licensee wants to buy a house listed by another brokerage for her own home. What must she do?

Show answer

Disclose in writing to the seller (typically in the offer) that she is a licensed real estate licensee buying for herself. Licensees must disclose their license status and personal interest when buying or selling for their own account.

8. Hard A title company offers a broker $200 for every client she sends its way, with no other service provided. What law and duty are involved?

Show answer

The federal Real Estate Settlement Procedures Act prohibits kickbacks and unearned fees for referring settlement-service business, so the payment is illegal. It also breaches loyalty, because it gives the broker an undisclosed financial reason to steer clients.

9. Hard A listing ends without a sale. Six months later, the former listing agent represents a buyer interested in the same house and tells the buyer, “The seller is behind on his mortgage — offer low.” Evaluate.

Show answer

It breaches confidentiality, which survives the end of the agency. The agent learned of the seller’s finances as his fiduciary and may not use that information against him later.

10. Hard A seller’s agent notices fresh paint on one basement wall, a dehumidifier and a musty smell, but the seller’s disclosure says “no water problems.” The agent says nothing. Why might the agent be liable even though he did not know for certain about water problems?

Show answer

Licensees are held to what they knew or reasonably should have known. Obvious red flags call for inquiry — asking the seller, recommending an inspection, disclosing what was observed — and ignoring them can support liability for negligent misrepresentation or concealment.

11. **Challenge** Name the elements of fraud, and apply them to a seller who answers a buyer's question, "Has the house ever had termites?" with "Never," knowing it was treated two years ago.

Show answer

A false statement or concealment of a material fact, made knowingly or recklessly, intended to induce reliance, actually and reasonably relied on, causing damage. The seller made a knowingly false statement of a material fact in answer to a direct question to induce the purchase; if the buyer relied on it and suffered loss, all elements are met, and the buyer may rescind or sue for damages.

12. **Challenge** Explain why Cardozo said Salmon breached his duty even though Salmon never told Meinhard a single lie, and connect the principle to a modern listing agent.

Show answer

A fiduciary must do more than avoid lies; he must disclose what the other party is entitled to know and may not divert opportunities that arise from the relationship. Salmon's silence about the new lease, which came to him because he managed the joint property, was itself the breach. A listing agent who learns of a better buyer, or of facts affecting the price, and stays silent to serve his own interests breaches the same duties of loyalty and disclosure.

COMMON MISTAKES

- Thinking confidentiality allows an agent to hide a known material defect. Defects must be disclosed; only the client's private information is confidential.
- Believing obedience requires following any client instruction. It covers lawful instructions only.
- Thinking a seller's agent owes a buyer-customer nothing. Customers are owed honesty, fair dealing and disclosure of known material defects.
- Calling enthusiastic opinion ("gorgeous kitchen") misrepresentation. That is puffing; misrepresentation concerns false statements of fact.
- Forgetting that confidentiality survives the end of the agency.
- Assuming a licensee may buy a listing quietly through a relative. Any personal interest must be disclosed in writing, and secret profits are a classic breach of loyalty.

Make it a game · OLD CAR Crash. Write O, L, D, C, A and R on six cards and deal one set to each player. The caller reads a short breach — "The agent told the buyer the seller's bottom price," "The agent kept the deposit in his own checking account," "The agent priced the home without looking at a single comparable." Players slap down the card for the duty breached; first correct card scores a point. Some cards are traps with no breach at all — puffing, or refusing an illegal instruction — and the right move is to slap nothing and shout "Clean!" for two points. First to fifteen wins and invents the final, hardest case.

Scripture. "He that is faithful in that which is least is faithful also in much: and he that is unjust in the least is unjust also in much." (Luke 16:10, KJV)

Jesus teaches that faithfulness with another's property is tested first in small things. A licensee's fiduciary duties are kept or broken in small moments — a remark on the phone, a deposit carried to the bank on time, a defect mentioned instead of skipped. Faithfulness in those least things is what makes an agent worthy of trust with the much of a family's home.

8.3 Listing Agreements

OBJECTIVES

- Distinguish the exclusive-right-to-sell, exclusive-agency, open and net listings, and state when the broker earns a commission under each.
- List the required elements of a listing agreement and explain protection (carryover) clauses and how listings terminate.
- Explain procuring cause, the MLS and cooperation, and the August 2024 MLS rule that offers of compensation are not published on the MLS.
- Explain why commissions are always negotiable and why fixing them violates antitrust law.
- Compute total commissions, brokerage-to-brokerage splits and broker-to-agent splits.

> **Warm-up.** A family hires three different painters to bid on their fence and says, "Whoever finishes first gets paid." A second family hires one painter and says, "You're our only painter for the summer — even if Grandpa paints it himself, you get paid." In five minutes, write which arrangement each painter would rather have, and why. Those are the two ends of the listing spectrum.

WATCH

4 Types of Listing Agreements Every Real Estate Exam Covers

US Realty Training · 14:48

https://www.youtube.com/watch?v=1TBvr1r5AKg

> **WHEN TO WATCH**
> Watch after core idea three; build a four-row table as he goes — listing type, who may sell without owing a commission, and why a seller might choose it.

BACKUP VIDEO

How to Calculate a Two-Way Commission Split with Agent Cut - Real Estate Exam Math

Caffeinated Math Teacher · 4:14

https://www.youtube.com/watch?v=Il9rGtCQnYU

Watch before the project; work her example alongside her on paper, then check your calculator against it. Treat every rate she uses as an example.

KEY TERMS

listing agreement

An employment contract between a property owner and a brokerage authorizing the broker to market the property and find a ready, willing and able buyer, in exchange for compensation.

exclusive-agency listing

A listing in which one broker is the only agent, but the owner may sell the property himself without owing a commission.

net listing

A listing in which the seller receives a set net amount and the broker keeps everything above it; illegal or discouraged in many states because of the conflict of interest.

procuring cause

The broker whose efforts started an uninterrupted chain of events that resulted in the sale; the usual test for who earned a commission in an open listing or a dispute.

exclusive-right-to-sell listing

A listing in which one broker is owed the commission no matter who sells the property during the term, even the owner.

open listing

A non-exclusive listing given to any number of brokers; only the broker who is the procuring cause of the sale is paid, and the owner may sell himself without owing anyone.

multiple listing service (MLS)

An organization of brokers who share listing information so that member brokers can cooperate in selling one another's listings.

protection (carryover) clause

A listing clause entitling the broker to a commission if, within a stated period after expiration, the property is sold to a buyer the broker introduced during the term, unless it is relisted with another broker.

ready, willing and able buyer

A buyer prepared to buy on the listing's terms or terms the seller accepts, with the financial capacity to close; producing one generally earns the commission.

antitrust (price fixing)

An agreement among competitors to set prices or commission rates, illegal under the Sherman Antitrust Act; commissions are always negotiable between broker and client.

commission split

The division of a commission between cooperating brokerages, and then between each broker and its licensee, as agreed in writing.

CORE IDEAS

The story. In the 1940s the real estate board of Washington, D.C., published a schedule of "standard" commission rates — so much on a house sale, so much for collecting rents, so much for arranging a loan — and its members charged them. The board called the rates recommended, but its code of ethics told members not to undercut them, and in practice nearly everyone charged the same. The United States sued, charging that the board and the national association of boards had fixed prices in violation of the Sherman Antitrust Act. The brokers answered that real estate brokerage was a profession, not "trade," and that their rates were only advisory. On May 8, 1950, in *United States v. National Association of Real Estate Boards*, the Supreme Court disagreed. Real estate brokerage is trade, Justice William O. Douglas wrote for the Court, and an agreement among competitors to adhere to a schedule of prices is price fixing, whether or not anyone is punished for breaking it. Ever since, the rule has been plain: every commission is negotiated between a broker and a client.

How they figured it out. The 1950 decision did not end every fee schedule at once. Boards and bar associations kept "suggested" rates for years, until a Virginia couple buying a house in 1971 found that every lawyer they asked would examine their title only at the county bar's minimum fee — a percentage of the price. In *Goldfarb v. Virginia State Bar* (1975), the Supreme Court held that minimum fee schedules for title work were also illegal price fixing, and in the 1970s federal and state enforcement actions against real estate boards' commission practices followed. The

lesson for licensees has never changed: no law, board, association or MLS sets commissions; each brokerage sets its own policies, each client may negotiate, and even a casual conversation between competing brokers about "what we all charge" can look like a conspiracy. The same antitrust law shaped the MLS rules adopted in August 2024 after the settlement of nationwide lawsuits over how buyer brokers were paid: as of 2026, offers of compensation to buyer brokers are not published on the MLS, and a buyer working with an agent signs a written agreement before touring a home (Lesson 8.4).

The big idea. A **listing agreement** is an employment contract — and an agency agreement — between an owner and a **brokerage**. It makes the broker a **special agent**, authorized to market the property and find a **ready, willing and able buyer**; it does not authorize the broker to sign a sales contract or convey title. There are four types. In an **exclusive-right-to-sell** listing, the broker earns the commission no matter who sells during the term — another broker, the owner himself, anyone. It is the most common and the broker's favorite, because it rewards the broker's marketing investment. In an **exclusive-agency** listing, the broker is the only agent, but the owner reserves the right to sell the property himself without paying a commission. In an **open listing**, the owner may list with any number of brokers and owes a commission only to the one who is the **procuring cause** of the sale; if the owner sells himself, no one is paid. A **net listing** sets the seller's net amount and lets the broker keep everything above it — illegal in many states and discouraged nearly everywhere, because it tempts the broker to underprice the property or conceal its value from the owner.

Most states require a listing to be **in writing** and signed for the broker to enforce a commission, and require a **definite termination date**; many prohibit automatic renewal clauses. A sound listing also identifies the property and all the owners who must sign, states the listing price and terms, the broker's compensation and how it is earned, the broker's authority (to place a sign, use a lockbox, advertise, share data with the MLS), the seller's duties of disclosure and cooperation, and any **protection** or **carryover clause**: if within a stated period after expiration — in this example 90 days — the owner sells to a buyer the broker introduced during the term, the commission is still owed, unless the owner has relisted with another broker. The listing belongs to the **broker**, not to the salesperson who took it, and a salesperson may be paid only by his own employing broker. The **listing price** is the seller's

decision. The broker supplies a comparative market analysis or opinion of value — honestly, even when a higher number would win the listing — but the seller sets the price, and a broker who "buys" a listing with an inflated estimate fails the duty of reasonable care.

A **multiple listing service** is a cooperative of brokers who share their exclusive listings so that any member's buyers can see them, which is why almost every exclusive-right-to-sell listing goes on the MLS. Historically the listing broker's MLS entry carried a blanket offer of compensation to cooperating brokers; under the rules in effect since August 2024, as of 2026, offers of compensation are not published on the MLS. A listing broker and seller may still decide to offer compensation to a buyer's broker or a concession to the buyer, but that is communicated and negotiated outside the MLS. A listing ends the same ways any agency ends: **performance** (the sale closes), **expiration**, **mutual agreement**, **revocation** by the seller (possibly with liability for the broker's damages), **renunciation** by the broker, or by operation of law — the death or incapacity of the seller or the broker, destruction or condemnation of the property, bankruptcy, or loss of the broker's license. When is the commission earned? Commonly when the broker produces a ready, willing and able buyer on the listing's terms or terms the seller accepts — even if the seller later refuses to close — though many listings provide that it is payable at closing.

Commission arithmetic is a favorite of the exam, and every rate is an example. The total commission is the sale price times the agreed rate. If the listing brokerage has agreed to share with a cooperating brokerage, the commission is split between the firms — in this example half and half. Each firm then splits its share with its own licensee under their written agreement — in this example 60% to the agent and 40% to the broker, or a graduated plan. A sale of $400,000 at a 5% commission produces $20,000; split evenly between firms, each firm receives $10,000; a listing agent on a 60% split earns $6,000. Work these problems in that order — price, total commission, firm share, agent share — and label each step. Net-listing problems show why the device is risky: if a seller insists on netting $300,000 and the house sells for $340,000, a net-listing broker keeps $40,000, a sum the seller never agreed to as a rate. And one rule bears repeating: a salesperson may never receive a commission directly from a seller, a buyer or another brokerage — all compensation flows through the employing broker.

On the exam today. Expect three to five questions on listings, at least one with arithmetic. The traps: under an *exclusive right to sell*, the broker is paid even when the owner finds the buyer; under an *exclusive agency*, the owner who sells himself owes nothing; under an *open listing*, only the procuring cause is paid; a *net listing* is illegal or discouraged because of the conflict of interest. The listing belongs to the *broker*, and the salesperson is paid only by his broker. A listing is an agency contract that ends at the seller's or broker's death; most states require a written listing with a definite end date. The protection clause survives expiration but yields to a new exclusive listing. Commissions are *always negotiable*; any statement that a board, MLS or law sets "the standard rate" is wrong and points to price fixing. As of 2026, offers of compensation to buyer brokers are not published on the MLS. And in commission math, find the total first, then the firm's share, then the agent's.

PICTURE STUDY



Crawford and Conover, Real Estate and Financial Brokers, Office Staff, Unknown photographer, 1890 · Photograph · University of Washington Libraries, Special Collections, Seattle

Image: Wikimedia Commons, public domain

This portrait shows the staff of Crawford & Conover, real estate and financial brokers, in Seattle in 1890 — the year after the Great Fire of June 6, 1889 had burned the city's business district to the ground. The rebuilding brought a boom in land sales, and offices like this one listed lots, arranged loans, collected rents and drew up papers for a city growing by the month. The unnamed studio photographer posed them like a family, bowler hats and walking sticks in hand, with the office boy in the middle. They open this lesson because a listing is a contract with a brokerage firm like this one — a team of people answerable to one broker.

Look closely

- Count the people. One firm, several licensees and an office boy: the client's contract was with the firm, and every man here worked under it.
- Find the small x marked above one man's head. Someone, perhaps years later, marked a person to remember — the way a protection clause keeps a record of introduced buyers.
- Look at the walking sticks and the suits. In 1890 a broker's appearance was part of his advertising; trust was the product.

- Notice the boy in uniform. Offices like this employed messengers to carry listings, contracts and money across a city without telephones in every office.

Talk about it

1. If a Seattle owner in 1890 had given this firm an exclusive right to sell, and then sold his lot to a neighbor himself, would the firm have been owed a commission? What if he had given an open listing to three firms?
2. Why do you think the law says a listing belongs to the broker and not to the salesman who signed up the seller?
3. Paul wrote that “the labourer is worthy of his reward.” How can a broker earn his commission honestly, and how can a seller pay it honestly?

PROJECT

The Listing Desk: Four Listings and a Commission Calculator

In this project you will set up the listing desk of a pretend brokerage: four pretend sellers, each with a different listing type and a short story about how the house finally sold, and a commission calculator that works out who is paid what. The calculator will carry every rate as an example, because commissions are negotiated case by case.

You will need

- A free spreadsheet (Google Sheets or LibreOffice Calc)
- A basic calculator for checking
- Your state real estate commission's rules on listing agreements (search the commission's official site for "listing agreement requirements" or the license law)

Steps

1. Create four pretend sellers with one listing each: exclusive right to sell, exclusive agency, open listing given to three brokerages, and a net listing (mark this one "for study only — check your state's law").
2. For each, write a two-sentence sale story (who found the buyer, when, at what price) and decide who earns a commission and why.
3. Build the calculator: inputs for sale price, total rate, cooperating split and agent split; outputs for total commission, each firm's share and each agent's share. Label every rate "in this example."
4. Test it against worked example one: it must return $24,000, $12,000 and $8,400.
5. Add a protection-clause checker: inputs for expiration date, sale date, protection period and whether the owner relisted; output "commission owed" or "not owed."
6. Look up your state's rules on listings — writing requirement, termination date, any ban on net or automatically renewing listings — and record the citations and the date.

7. Title the pages “The Listing Desk,” date them and add them to your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, with a four-panel card comparing the listing types by one question: “If the owner sells it himself, does the broker get paid?”
2. Draw a commission waterfall: SALE PRICE → TOTAL COMMISSION → LISTING FIRM / COOPERATING FIRM → AGENT / BROKER, with one worked set of example numbers.
3. Write a trap list titled “Listings”: exclusive right to sell pays even if the owner sells; exclusive agency doesn’t; open = procuring cause only; net = conflict; listing belongs to the broker; commissions always negotiable; no MLS compensation offers as of 2026.

KEY FORMULAS

$$\text{total commission} = \text{sale price} \times \text{commission rate}$$
$$\text{firm's share} = \text{total commission} \times \text{firm's split}$$
$$\text{agent's share} = \text{firm's share} \times \text{agent's split}$$
$$\text{net-listing broker's fee} = \text{sale price} - \text{seller's net}$$

From history. Real estate exchanges and boards sprang up in American cities in the late 1800s, partly so that brokers could meet and swap information about the properties they had for sale — the seed of today’s multiple listing service. In 1908 delegates from a number of local boards met in Chicago and formed a national association. Its members soon pressed for state licensing laws, beginning with California’s act of 1917 and Michigan’s of 1919, so the public could tell a trained broker from a stranger with a sign.

Example 1. Exam style. A house sells for $480,000. In this example, the listing agreement provides a 5% commission, the listing brokerage shares half with the cooperating brokerage, and the listing agent's split with her broker is 70/30 in her favor. The listing agent earns:

A. $24,000

B. $12,000

C. $8,400

D. $3,600

Show solution

1. Total commission: $\$480{,}000 \times 0.05 = \$24{,}000$.
2. Listing firm's share: $\$24{,}000 \times 0.50 = \$12{,}000$.
3. Agent's share: $\$12{,}000 \times 0.70 = \$8{,}400$.
4. D is the broker's 30% ($3,600); B is the firm's share; A is the whole commission.

Answer: C. $8,400 — total, then firm share, then agent share.

Example 2. A seller signs a six-month exclusive-agency listing. In month two, the seller's coworker buys the house directly from the seller, with no help from any broker. In a second case, a different seller signs an exclusive-right-to-sell listing, and the same thing happens. Who owes what?

Show solution

1. Exclusive agency: the broker is the only agent, but the owner reserved the right to sell himself. The coworker bought directly from the owner, so no commission is owed.
2. Exclusive right to sell: the broker is owed the commission no matter who sells during the term — including the owner.
3. So the second seller owes the full agreed commission even though the broker did not find the buyer.
4. This is the single most-tested difference between listing types.

Answer: Exclusive agency: no commission. Exclusive right to sell: the full commission is owed.

Example 3. A 90-day exclusive-right-to-sell listing with a 60-day protection clause expires on June 30. The broker had shown the house to the Nguyens in May. On August 10 the owner, who has not relisted, sells to the Nguyens directly. On a second property, the owner relists with a new broker on July 1 and sells through the new broker to a buyer the first broker had shown in May. Is the first broker owed a commission in either case?

Show solution

1. Case one: the sale occurred 41 days after expiration, within the 60-day protection period, to a buyer the broker introduced, and the owner had not relisted — the commission is owed.
2. Case two: protection clauses commonly end their effect if the owner signs a new exclusive listing with another broker, so the owner does not owe two commissions.
3. In case two the first broker is ordinarily not owed a commission, depending on the exact clause.
4. The broker should have given the owner a written list of introduced buyers at expiration, as many clauses require.

Answer: Case one: yes, under the protection clause. Case two: ordinarily no, because the owner relisted with another broker.

PRACTICE

1. Easy Under which listing does the broker earn a commission even if the owner sells the property himself?

   Show answer

   The exclusive-right-to-sell listing — the broker is paid no matter who sells during the term.

2. Easy Who sets real estate commission rates?

   Show answer

   Each brokerage and its client, by negotiation. No law, board, association or MLS sets them; fixing them among competitors is illegal price fixing under the Sherman Antitrust Act.

3. **Easy** Does a listing agreement belong to the salesperson who took it or to the brokerage?

Show answer

To the brokerage. The salesperson acts for the broker, and the client's contract is with the firm.

4. **Medium** A house sells for $325,000 at a 6% commission (in this example), split 50/50 between firms. The selling agent receives 55% of her firm's share. What does she earn?

Show answer

Total $\$325{,}000 \times 0.06 = \$19{,}500$; firm share $\$9{,}750$; agent $\$9{,}750 \times 0.55 = \$5{,}362.50$.

5. **Medium** An owner gives open listings to three brokers. Broker A shows the house to a buyer, who later returns with Broker B and buys. Who is paid?

Show answer

The broker who was the procuring cause — whose efforts started the uninterrupted chain leading to the sale. That is often decided on the facts; if Broker B's efforts actually produced the sale, B is paid, and only one commission is owed.

6. **Medium** Why are net listings illegal or discouraged in many states?

Show answer

Because the broker keeps everything above the seller's net, giving the broker a reason to encourage a low net, conceal the property's true value or steer toward a quick underpriced sale — a direct conflict with the duty of loyalty.

7. **Medium** As of 2026, may a listing broker place an offer of compensation to buyer brokers in the MLS listing?

Show answer

No. Under MLS rules adopted in August 2024, offers of compensation to buyer brokers are not published on the MLS. Any such offer, or a seller concession to the buyer, is communicated and negotiated outside the MLS.

8. Hard A listing broker produces a buyer who signs an offer at the full listing price on the listing's exact terms and is fully qualified. The seller then refuses to sign. Has the broker earned a commission?

Show answer

Generally yes. Producing a ready, willing and able buyer on the listing's terms earns the commission under the traditional rule, even if the seller refuses to sell — though the listing's own wording controls, and many listings make the commission payable only at closing.

9. Hard A seller insists on netting $410,000 under a net listing (where legal in this example), and the house sells for $455,000. What is the broker's fee as a percentage of the sale price, and what is the ethical problem?

Show answer

Fee $\$455{,}000 - \$410{,}000 = \$45{,}000$, which is $\$45{,}000 \div \$455{,}000 \approx 9.9\%$ of the price. The seller never agreed to that rate, and the broker profited by the gap between the true value and the net — exactly the conflict that makes net listings illegal or discouraged.

10. Hard A broker tells a prospective seller, "The standard commission in this town is 6% — everyone charges it." What is wrong with that statement?

Show answer

There is no standard commission. Rates are set by each firm and negotiated with each client; implying a uniform rate misleads the seller and suggests price fixing among competitors, which antitrust law forbids.

11. Challenge A sale closes at $612,000. The total commission was $27,540. The listing firm keeps 55% of it and pays the rest to the cooperating firm. The listing agent receives 65% of her firm's share. Find the commission rate, the cooperating firm's share and the listing agent's pay.

Show answer

Rate $\$27{,}540 \div \$612{,}000 = 4.5\%$. Cooperating firm $\$27{,}540 \times 0.45 = \$12{,}393$. Listing firm $15,147; agent $\$15{,}147 \times 0.65 = \$9{,}845.55$.

12. **Challenge** A broker lists a home at $520,000 after telling the sellers it "could easily bring $550,000," though her comparables supported about $495,000. Which duty did she breach, and why does it matter that the sellers set the price?

Show answer

Reasonable care and skill (and honesty): she gave an opinion of value she knew the data did not support in order to win the listing. The sellers set the price, but they rely on the broker's honest analysis to do it, so an inflated estimate misleads them into a decision that may cost them time and money.

COMMON MISTAKES

- Saying an exclusive-agency broker is paid when the owner sells himself. Only the exclusive-right-to-sell broker is.
- Thinking any law or association sets a standard commission. Commissions are always negotiable; fixing them is price fixing.
- Believing the salesperson owns the listing or may be paid directly by the seller. The listing and all compensation belong to and flow through the broker.
- Computing the agent's share from the total commission instead of from the firm's share.
- Forgetting that a protection clause usually does not apply if the owner relists with another broker.
- Assuming offers of compensation still appear on the MLS. As of 2026, under rules adopted in August 2024, they do not.

> **Make it a game · Who Gets Paid?.** Make four listing cards — EXCLUSIVE RIGHT TO SELL, EXCLUSIVE AGENCY, OPEN, NET — and a deck of sale-story cards: "The owner's cousin buys it directly," "Broker B brings the buyer," "The house sells 30 days after expiration to a buyer Broker A showed." Flip one listing card and one story card. Players race to call out who gets paid, and the first right answer earns a point. Then roll two dice for a sale price (dice total × $50,000) and race to compute the agent's pay at a 5% commission split 50/50 and 60/40, in this example. Most points after ten rounds wins.

> **Scripture.** “For the scripture saith, Thou shalt not muzzle the ox that treadeth out the corn. And, The labourer is worthy of his reward.” (1 Timothy 5:18, KJV)
>
> Paul quotes both the Law and the words of Jesus to teach that honest work deserves honest pay. A listing agreement is a promise of reward for real labor — marketing, advising, negotiating — and both sides should keep it: the broker by earning the commission with diligent, truthful work, and the seller by paying what was freely negotiated.

8.4 Buyer Agency, Dual Agency and Other Relationships

OBJECTIVES

- Describe exclusive, exclusive-agency and open buyer representation agreements, and the 2024 MLS rule requiring a written agreement before touring.
- Explain the ways a buyer's broker may be compensated and why the written agreement must state that compensation.
- Define dual agency, the informed written consent it requires and the duties it limits, and recognize undisclosed dual agency as a violation.
- Distinguish dual agency, designated agency, transaction brokerage (non-agency) and in-house sales.
- Explain when and how agency relationships must be disclosed, using Washington's agency pamphlet as one state example.

> **Warm-up.** Imagine one referee officiating a basketball game while also coaching one of the teams. In five minutes, write down two things he could still do honestly for both teams, and two things he could no longer do for either. Then write one sentence on what both teams would need to agree to before letting him try.

WATCH

Real Estate Exam Prep | Dual Agency vs. Designated Agency

Real Estate School · 8:21

https://www.youtube.com/watch?v=bO_ephmH9yQ

> **WHEN TO WATCH**
> Watch after core idea four; draw his broker–agent–seller–buyer diagram in your notebook and mark which duties disappear in dual agency.

BACKUP VIDEO

What is Dual Agency? Real Estate Exam Topics Explained

PrepAgent · 4:13

https://www.youtube.com/watch?v=qTqlMVMww0Q

Watch before the practice set; afterward, list the duties a dual agent keeps and the ones he gives up, and check your list against core idea five.

buyer representation agreement

A written agreement in which a buyer engages a brokerage to represent the buyer in finding and purchasing property, stating the term, the services and the broker's compensation.

exclusive-agency buyer agreement

A buyer agreement under which the broker is the buyer's only agent, but the buyer owes nothing if he finds a property entirely on his own.

dual agency

Representation of both the buyer and the seller in the same transaction by the same licensee or brokerage, lawful only with both parties' informed written consent.

transaction broker (facilitator)

A licensee who assists one or both parties without representing either as an agent, owing duties such as honesty, reasonable care and accounting, as state law defines.

in-house sale

A sale in which the listing and the buyer's side are handled by licensees of the same brokerage.

exclusive buyer agency agreement

A buyer agreement under which the broker is compensated if the buyer buys any property of the type described during the term, however it is found.

open buyer agency agreement

A non-exclusive buyer agreement under which the buyer may work with several brokers and pays only the one who locates the property purchased.

designated agency

An arrangement in which the managing broker of one firm appoints one licensee to represent the seller and another to represent the buyer, each owing full duties to his own client.

undisclosed dual agency

Representing both parties without their informed consent, a violation that can cost the broker the commission, support rescission and lead to license discipline.

agency disclosure

A required explanation, often on a state form or pamphlet, of whom a licensee represents, given early in the relationship and before confidential information is shared or an offer is signed.

seller concession

A seller's agreement to pay some of the buyer's costs at closing, which may include part of the buyer's brokerage fee where the parties so negotiate.

CORE IDEAS

The story. In 1770 Benjamin Franklin, already famous for his experiments with electricity, was living in London as a professional agent. The Pennsylvania Assembly had employed him there for years to press its business before the British government; Georgia had appointed him its agent in 1768, New Jersey in 1769, and that autumn the Massachusetts House of Representatives named him its agent too. At the same time he held a Crown office — deputy postmaster general for the American colonies. For a while one able man could serve all these principals, because their business rarely collided. But as relations between Britain and the colonies grew strained, Franklin found himself between masters whose interests now pulled in opposite directions. In January 1774, after a bitter dispute over private letters he had sent home to Massachusetts, he was summoned before the King's Privy Council, harshly rebuked, and dismissed from his post office two days later. He returned to Philadelphia the following year. His career is the oldest lesson in this chapter: one agent can serve several principals honestly only while their interests do not conflict — and everyone must know whom he serves.

How they figured it out. Real estate faced the same question two centuries later. Once buyers could hire their own agents (Lesson 8.1), a brokerage that listed a home and also represented a buyer who wanted that home was, by definition, representing both sides. The common law had a short answer — an agent may not serve two principals with adverse interests without the full, informed consent of both — and states built on it in different ways from the 1990s onward. Some permit **dual agency** with written consent and spell out its limited duties. Some created **designated agency**, in which a firm assigns separate licensees to each side. Some created **non-agency** roles — a **transaction broker** or **facilitator** who helps both parties close without representing either. A few prohibit dual agency outright. Every state, however, requires **disclosure**: a buyer or seller must be told, early and in writing, whom the licensee represents. The national exam tests the shared pattern; your state's license law decides the details.

The big idea. A buyer becomes a client through a **buyer representation agreement**. In an **exclusive buyer agency** agreement (sometimes called an exclusive right to represent), the broker is compensated if the buyer buys a described type of property during the term, however it is found. In an **exclusive-agency** buyer agreement, the broker is the only agent, but the buyer owes nothing if he finds a property entirely by himself. In an **open** buyer agreement, the buyer may work with several brokers and pays only the one who finds the property he buys. As of 2026, under MLS practice rules adopted in August 2024 after the settlement of nationwide antitrust lawsuits, a licensee working with a buyer must have a **written agreement** with that buyer before touring a home. The agreement must state the broker's compensation as a definite amount or rate (or a clear way to calculate it), must provide that the broker may not receive more than that amount from any source, and must state conspicuously that broker fees are not set by law and are fully negotiable. The agreement creates whatever relationship the parties and state law provide — agency, or a non-agency relationship where the state allows it.

How is the buyer's broker paid? There are three common routes, and the exam treats them as mechanics. The **buyer may pay directly**, as agreed in the representation agreement. The buyer may negotiate a **seller concession** — the seller agrees in the purchase agreement to pay some of the buyer's costs at closing, which may include all or part of the buyer's brokerage fee. Or the **listing broker may offer compensation** to cooperating buyer brokers, with the seller's authorization; as of 2026 such offers are not published on the MLS but may be communicated and negotiated outside it. Whatever the source, the total the buyer's broker receives may not exceed what the buyer's written agreement allows, and if another source pays less than the agreement states, the buyer may owe the difference unless the agreement says otherwise. And remember the rule from Lesson 8.1: **compensation does not determine agency**. A buyer's broker paid from the seller's proceeds still owes every fiduciary duty to the buyer.

Dual agency occurs when one licensee, or one brokerage, represents both buyer and seller in the same transaction — most often in an **in-house sale**, when a firm's buyer client wants the firm's listing. Where it is lawful, it requires the **informed written consent** of both parties, usually given in advance and confirmed when the situation arises. The dual agent must be neutral. He may not advocate for either side on price, and may not disclose either party's confidential information — the seller's

willingness to take less, the buyer's willingness to pay more, either party's motivation — without that party's permission. He still owes both parties honesty, reasonable care, accounting and disclosure of known material defects. **Undisclosed dual agency** — representing both sides without consent, or drifting into it by advising a buyer while holding the listing — is a serious violation that can lead to loss of the commission, rescission of the sale and license discipline. In **designated agency**, the managing broker appoints one licensee for the seller and another for the buyer, each giving full advocacy to his own client; in many states the managing broker is then considered a dual agent with limited duties.

Some states offer a **transaction broker** or **facilitator** role, a **non-agency** relationship in which the licensee helps one or both parties complete a transaction without representing either. Such a licensee owes the duties the state lists — commonly honesty, reasonable skill and care, accounting for funds and disclosure of known material defects — but not loyalty, advocacy or full confidentiality. States differ on whether this is the default relationship, so learn your own. **Agency disclosure** is the safeguard that ties all these choices together. A licensee must tell each party, early and in writing, whom the licensee represents — typically at the first substantive contact and before any confidential information is shared or any offer is written — and confirm it in the purchase agreement. Washington, for example, requires a broker to give a party a pamphlet on the law of real estate agency, in the form the statute prescribes, and to obtain an acknowledgment of receipt — for a client, as soon as reasonably practical but before the party signs a services agreement. Other states use their own forms and timing; check your commission's rules.

On the exam today. These relationships are tested as scenarios, and the right answer almost always turns on consent and disclosure. The traps: dual agency is lawful only with the *informed written consent* of both parties, where state law permits it; a dual agent may *not* tell the seller the buyer will pay more, or the buyer the seller will take less; a dual agent still discloses known material defects; *undisclosed* dual agency is a violation, and it can arise by conduct, not just by contract; in designated agency, each designated licensee gives full representation to his own client; a transaction broker or facilitator represents neither party; compensation does not determine agency. As of 2026, a buyer working with an agent signs a written agreement before touring, that agreement states the compensation and that fees are negotiable, and offers of compensation do not appear on the MLS. And when a question asks when

agency must be disclosed, choose the earliest substantive moment — before confidential information is exchanged — not “at closing.”

PICTURE STUDY



The Merchant Georg Gisze, Hans Holbein the Younger, 1532 · Oil on oak panel · Gemäldegalerie, Berlin

Image: Wikimedia Commons, public domain

Hans Holbein the Younger, the German painter who became court painter to Henry VIII, painted this portrait in London in 1532 for Georg Gisze, a young merchant from Danzig living at the Steelyard, the London trading house of the Hanseatic League. Merchants like Gisze worked as factors — agents handling goods and money in a foreign city for family firms and partners back home — and Holbein filled the room with the tools of that trust: letters from his principals, a scale for honest weight, keys, a seal. He opens this lesson because his whole career depended on others believing that he served them faithfully, even across an ocean.

Look closely

- Find the letter in Gisze's hands and the others tucked on the wall. Painted letters on the wall carry his name and London address — messages from the people he served.
- Look for the balance scale hanging at the left. An agent who handles others' goods must weigh them honestly for every principal.
- Find the small clock on the table and the fragile glass vase. Holbein's viewers read them as reminders that time is short and fortunes can break.

- Read the Latin motto painted on the wall at the left, beside the scale: “No joy without sorrow.” Even a prosperous agent’s life carried risk.

Talk about it

1. Gisze may have handled goods for several merchants at once. What would he have to tell each of them, and what would he have to keep from each, to serve them all honestly?
2. When would serving two principals in the same deal become impossible for him, as it did for Franklin in 1774?
3. Jesus said, “No man can serve two masters.” What does that teach a licensee about dual agency, and why do so many careful brokers avoid it?

PROJECT

The Relationship Disclosure Packet

Disclosure is where honest agency begins. In this project you will assemble the packet a careful licensee would hand a new buyer: a plain-language explanation of the relationships available in your state, a sample (pretend) buyer agreement summary showing how compensation is stated, and a worksheet showing how the fee is paid from different sources. You will also script the conversation for the moment an in-house sale turns a single agency into a possible dual agency.

You will need

- Your state real estate commission's official agency disclosure form or pamphlet (Washington's is set out in RCW 18.86.120)
- A free word processor or the exam notebook
- A basic calculator

Steps

1. Download or read your state's agency disclosure form or pamphlet and list every relationship it describes (seller's agent, buyer's agent, dual agent, designated agent, transaction broker or other). Record the citation and the date.
2. Write a one-page plain-language explanation of each relationship: whom the licensee represents, what duties are owed, and what is lost in dual agency.
3. Write a one-page summary of a pretend buyer representation agreement: type (exclusive, exclusive agency or open), term, services, compensation stated as a definite amount or rate, the cap on total compensation, and the statement that fees are negotiable and not set by law.
4. Build a fee worksheet with inputs for price, agreed rate, seller concession and any listing broker's offer, and outputs for the buyer's balance and the cap. Test it on worked example two ($2,100 and $10,500).
5. Script a five-line conversation in which a buyer-client asks to see the brokerage's own listing, and the licensee explains dual or designated agency and asks for informed written consent.

6. Add a closing checklist: disclose at first substantive contact; written buyer agreement before touring; consent before any dual agency; defects always disclosed.
7. Title the packet “Relationship Disclosure Packet,” date it and add it to your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term, with the three buyer agreements on one card answering “If the buyer finds the home himself, does the broker get paid?”
2. Draw a four-panel chart: SINGLE AGENCY / DUAL AGENCY / DESIGNATED AGENCY / TRANSACTION BROKER, with rows for whom the licensee represents, consent required, and which duties are limited.
3. Write a trap list titled “Relationships”: dual agency needs informed written consent; dual agent can’t share price or motivation but must disclose defects; undisclosed dual agency can arise by conduct; written buyer agreement before touring as of 2026; fees negotiable and stated in the agreement; disclose relationships early.

KEY FORMULAS

$$\text{buyer broker's fee} = \text{purchase price} \times \text{agreed rate}$$
$$\text{buyer's balance owed} = \text{agreed fee} - \text{seller concession} - \text{listing broker's offer}$$

From history. Franklin’s London years included one of the most successful agency efforts in colonial history. In February 1766 he testified for hours before the House of Commons on the Stamp Act, answering more than 170 questions about American trade and opinion; within weeks Parliament repealed the act. His printed “Examination” became a best-seller on both sides of the Atlantic — a model of an agent presenting his principals’ case clearly, factually and in their interest.

Example 1. Exam style. A brokerage lists a home. One of its licensees, who has a written buyer agreement with a family, learns the family wants that very home. With both parties' informed written consent, the brokerage acts as a dual agent. Which action is permitted?

A. Telling the seller the buyers will pay up to $15,000 more than their offer

B. Telling the buyers the seller must sell within 30 days

C. Disclosing to the buyers that the roof leaks, as the seller admitted

D. Advising the seller to reject the offer and counter higher

Show solution

1. A dual agent must remain neutral and keep each party's confidential information from the other unless authorized.
2. A reveals the buyers' top price; B reveals the seller's motivation — both confidential.
3. D is advocacy for one side against the other — not permitted to a neutral dual agent.
4. C is a known material defect; every licensee, including a dual agent, must disclose it to the buyer.

Answer: C. Disclosure of known material defects continues in dual agency; confidential price and motivation do not.

Example 2. A buyer's written agreement sets her broker's fee at 2.5% of the purchase price (in this example). She buys a home for $420,000. The seller agrees in the purchase agreement to a $6,000 concession toward the buyer's brokerage fee, and the listing broker, with the seller's authorization, offers the buyer's broker $2,400 outside the MLS. How much does the buyer pay her broker, and what is the most the broker may receive?

Show solution

1. Agreed fee: $\$420{,}000 \times 0.025 = \$10{,}500$.
2. Other sources: $\$6{,}000 + \$2{,}400 = \$8{,}400$.
3. Buyer's balance: $\$10{,}500 - \$8{,}400 = \$2{,}100$.
4. Cap: the broker may not receive more than $10,500 from all sources combined, as the agreement must provide.

Answer: The buyer pays $2,100; the broker receives $10,500 in total and no more.

Example 3. At an open house for her own listing, a licensee meets an unrepresented buyer who asks her to "help me get this house for less." She spends an hour advising him on price and strategy, writes his offer, and never mentions agency. The seller accepts. Afterward the seller learns what happened. Analyze.

Show solution

1. The licensee already represented the seller under the listing.
2. By advising the buyer on price and strategy, she acted as his agent too — an implied agency created by conduct.
3. Neither party gave informed written consent, and no agency disclosure was made: this is undisclosed dual agency.
4. Consequences may include forfeiture of the commission, rescission or damages, and license discipline. She should have disclosed her role at first contact and either treated the buyer as a customer or followed her state's consent procedure.

Answer: An undisclosed dual agency created by conduct — a violation exposing the licensee and her broker to loss of commission, civil liability and discipline.

PRACTICE

1. Easy What is dual agency, and what does it require?

   Show answer

   Representation of both buyer and seller in the same transaction by the same licensee or brokerage. Where state law permits it, it requires the informed written consent of both parties.

2. Easy As of 2026, under MLS rules adopted in August 2024, what must a licensee working with a buyer have before touring a home?

   Show answer

   A written agreement with the buyer, stating the broker's compensation as a definite amount or rate, limiting total compensation to that amount, and stating that fees are not set by law and are negotiable.

3. Easy Under an exclusive-agency buyer agreement, does the buyer owe the broker a fee if he finds a house entirely on his own?

Show answer

No. The broker is the buyer's only agent, but the buyer reserves the right to find and buy property himself without owing a fee. Under an exclusive buyer agency agreement, he would owe it.

4. Medium Name three ways a buyer's broker may be compensated.

Show answer

Directly by the buyer under the representation agreement; through a seller concession negotiated in the purchase agreement; or by the listing broker's offer of compensation, authorized by the seller and communicated outside the MLS.

5. Medium In designated agency, what duties does each designated licensee owe?

Show answer

Full fiduciary duties and advocacy to his own client — one licensee to the seller, the other to the buyer. The managing broker who designated them is, in many states, treated as a dual agent with limited duties.

6. Medium How does a transaction broker or facilitator differ from an agent?

Show answer

A transaction broker assists one or both parties without representing either, owing the duties the state lists — commonly honesty, reasonable care, accounting and disclosure of known defects — but not loyalty, advocacy or full confidentiality.

7. Medium A seller's agent is paid from the sale proceeds, and the buyer's agent is paid by a seller concession. Whom does the buyer's agent represent?

Show answer

The buyer. Compensation does not determine agency; the buyer representation agreement does.

8. Hard A buyer's agreement sets a 3% fee (in this example). The buyer purchases for $350,000, and the seller agrees to a $7,000 concession toward the fee. No other compensation is offered. What does the buyer owe the broker?

Show answer

Fee $\$350{,}000 \times 0.03 = \$10{,}500$; balance $\$10{,}500 - \$7{,}000 = \$3{,}500$, paid by the buyer unless the agreement provides otherwise.

9. Hard A dual agent, with proper written consent, tells the buyer, "The seller has rejected two offers below $400,000, so don't bother going lower." Is this a problem?

Show answer

Yes, unless the seller authorized it. It reveals the seller's negotiating position, which a neutral dual agent must keep confidential. The agent may present offers and facts but may not advise either side on price against the other.

10. Hard When should a licensee disclose whom he represents, and why does timing matter?

Show answer

At the first substantive contact — before confidential information is exchanged or any offer is written — and in the form and time the state requires. If disclosure comes later, a customer may already have revealed his top price or motivation to an agent who owes him no confidentiality.

11. Challenge A brokerage's buyer client wants to see a listing held by the same brokerage. The state permits dual and designated agency. Describe two lawful ways to proceed and one unlawful way.

Show answer

Lawful: (1) with both parties' informed written consent, proceed as a dual agency with neutral, limited duties; (2) where permitted, the managing broker designates separate licensees for buyer and seller, each giving full representation, with the required disclosures. Unlawful: proceed without telling the parties, with the licensee effectively advising both — undisclosed dual agency.

12. **Challenge** Using Franklin's story, explain in three sentences why consent and disclosure make dual agency lawful but cannot make it the same as single agency.

Show answer

> Franklin could serve several assemblies while their interests ran together, but when interests collided he could not advocate for both. Consent and disclosure let the parties choose a neutral agent with eyes open, so no one is deceived. But a neutral agent cannot also be each party's advocate on price and strategy — those duties are given up, which is why dual agency is a limited relationship and many brokers avoid it.

COMMON MISTAKES

- Thinking dual agency is lawful with oral or implied consent. It requires the informed written consent of both parties where state law allows it.
- Believing a dual agent may share the other side's price or motivation. Those remain confidential unless the party authorizes disclosure.
- Forgetting that a dual agent must still disclose known material defects.
- Assuming undisclosed dual agency requires a written agreement with both sides. It can arise by conduct, by advising a party the licensee does not represent.
- Concluding that whoever pays the buyer's broker is that broker's client. Compensation does not determine agency.
- Saying offers of buyer-broker compensation appear on the MLS, or that a buyer may tour with an agent before signing a written agreement. As of 2026, neither is the rule.

> **Make it a game · Two Masters.** One player is the licensee; two others are a buyer and a seller who each secretly write a confidential fact (a top price, a deadline, a reason for moving) and a defect or concern. The narrator announces the relationship — single agency for the seller, dual agency with consent, designated agency or transaction broker. The buyer and seller then question the licensee, trying to pry out the other side's secret. The licensee scores a point for every question answered honestly without leaking a confidence, and loses two for any leak; but if the seller's card lists a defect, the licensee must disclose it or lose three. Rotate roles until everyone has played the licensee.

> **Scripture.** “No man can serve two masters: for either he will hate the one, and love the other; or else he will hold to the one, and despise the other. Ye cannot serve God and mammon.” (Matthew 6:24, KJV)
>
> Jesus is speaking first of God and money, but the principle he states is the very principle of agency law: undivided loyalty cannot be split between masters whose interests compete. The law permits dual agency only by stripping it of advocacy and requiring both parties’ consent — an honest admission that no one can fully serve two masters at once.

8.5 Property Disclosures and Material Facts

OBJECTIVES

- Trace the shift from caveat emptor to modern disclosure law and describe the seller's property condition disclosure statement and common exempt transfers.
- Define material fact, material defect, latent defect and patent defect, and decide what must be disclosed in a scenario.
- Explain the licensee's duty to disclose known defects even when representing the seller, the effect of an "as is" clause, and the red flags that call for investigation.
- Explain how states treat stigmatized properties, and why licensees recommend inspections and surveys.
- State the federal lead-based paint disclosure requirements for pre-1978 housing and identify flood-zone, special-assessment and home-warranty disclosures.

> **Warm-up.** Walk through one room of your home with a pencil and paper for five minutes. List three things a buyer would see in ten seconds and three things a buyer could never see without being told — something behind a wall, under a floor or in the history of the house. Keep the list; it is the difference between a patent and a latent defect.

WATCH

Property Disclosures Explained (Real Estate Exam Prep)

Dee Kumar Real Estate · 8:04

https://www.youtube.com/watch?v=cBeG6qJ1ZwE

> **WHEN TO WATCH**
> Watch after core idea two; list every disclosure he names and mark each one F (federal), S (varies by state) or C (common law or contract).

BACKUP VIDEO

Pass the Real Estate Exam! What is a LATENT DEFECT? with Global Real Estate School

Global Real Estate School · 2:49

https://www.youtube.com/watch?v=ZDD-wLb6kOw

A short review after the core ideas: listen for how a latent defect differs from a patent one, then say in your own words what a seller and a listing agent must disclose.

KEY TERMS

caveat emptor

"Let the buyer beware" — the old rule that a seller had no duty to reveal defects and the buyer had to discover them for himself.

seller property condition disclosure statement

A state-required form on which a seller discloses known conditions of the property — roof, plumbing, water, structure, environmental and legal issues — before or soon after the purchase agreement.

material fact

A fact that a reasonable person would consider important in deciding whether to buy, sell or lease, or on what terms.

material defect

A physical condition that significantly affects the property's value or poses an unreasonable risk to people on it.

latent defect

A hidden defect that would not be revealed by an ordinary, reasonable inspection; known latent defects must be disclosed.

patent defect

A defect visible or readily discoverable on reasonable inspection, such as a cracked window.

stigmatized property

A property that buyers may avoid for psychological rather than physical reasons, such as a death, crime or rumored event on the premises; disclosure rules vary by state.

"as is" clause

A contract term in which the buyer accepts the property in its present condition; it does not excuse fraud or the concealment of known latent defects.

lead-based paint disclosure

The federal requirement that sellers and landlords of housing built before 1978 disclose known lead-based paint and hazards, provide records and an EPA pamphlet, include a warning statement and, for buyers, offer a 10-day opportunity to test.

home warranty

A service contract, typically for one year, that pays for repair or replacement of covered home systems and appliances that fail from normal use.

special flood hazard area

An area mapped by FEMA as subject to a 1% annual chance of flooding, in which federally regulated or insured lenders require flood insurance.

CORE IDEAS

The story. In May 1982 Morton and Edna Davis agreed to buy a three-year-old house in Florida from Clarence and Dana Johnson for $310,000, and paid deposits totaling $31,000. Before paying the second deposit, Mrs. Davis noticed buckling plaster and stains near a window and on a ceiling. Mr. Johnson told her the window had once had a minor problem that was long since corrected, and that the stains were wallpaper glue. A few days later, during a heavy rain, Mrs. Davis entered the house and found water gushing in around the window and pouring from the ceiling. Roofers the Davises hired reported that the roof needed to be replaced. The Johnsons had known about the leaks all along. The Davises refused to close and sued to recover their deposits. In 1985, in *Johnson v. Davis*, the Florida Supreme Court not only held the Johnsons liable for their false statements — it announced a new rule: where the seller of a home knows of facts materially affecting its value that are not readily observable and not known to the buyer, the seller must disclose them. The Davises recovered their $31,000.

How they figured it out. For most of history the rule ran the other way. In *Laidlaw v. Organ* (1817), a New Orleans merchant learned early of the treaty ending the War of 1812 and bought a large lot of tobacco before the news, which sent prices up, became public. Chief Justice John Marshall held that the buyer had no duty to share the news, so long as he did not lie — **caveat emptor**, let the buyer beware. Applied to

houses, that rule let a seller stay silent about a leaking roof. Courts chipped away at it through the twentieth century, first for active concealment, then for half-truths, and finally for silence about known latent defects. In 1984 a California court in *Easton v. Strassburger* went further and held a listing broker liable for failing to discover and disclose signs of soil problems that a reasonably competent inspection would have revealed. California then adopted a statutory seller disclosure form in the late 1980s, and most states followed with their own **seller property condition disclosure statements**. Today the rule is close to the reverse of 1817: known material defects must be disclosed.

The big idea. A **material fact** is one a reasonable person would consider important in deciding whether to buy, or at what price. A **material defect** is a physical condition that significantly affects value or poses an unreasonable risk to occupants — a failing roof, a cracked foundation, a broken septic system, mold, a buried fuel tank. Defects are **patent** if visible on reasonable inspection and **latent** if hidden. The law of disclosure now rests on three pillars. First, most states require the seller of a residence to complete a **seller disclosure statement** — the forms differ by state — reporting known conditions of the structure, systems, water, environmental hazards and legal matters such as boundary disputes. Common exemptions include foreclosure and other court-ordered sales, transfers by personal representatives and trustees in some states, transfers between co-owners or family members, and some new construction; check your state's list. Second, the common law forbids fraud, misrepresentation and active concealment by anyone. Third, license law requires every licensee to disclose known material defects to buyers — even when the licensee represents the seller.

Where does a licensee's duty begin and end? A licensee must disclose material defects he **knows** of and, in many states, those he reasonably **should have known**. He is not a home inspector, and he is not required to discover what only an expert could find — but he must not close his eyes to **red flags**: water stains, fresh paint on one patch of ceiling, cracks in walls or foundations, sloping floors, a musty odor, a sump pump running in dry weather, an oil fill pipe with no visible tank, or a neighboring use — a landfill, a commercial operation — that may affect value. When he sees one, the right response is to ask, to disclose what he observed, and to recommend that the buyer obtain a professional **inspection**, a **survey** (for boundary and encroachment questions) or a specialist's report. A seller may sell **"as is,"** and

the buyer then accepts the condition he can see or discover; but "as is" does not shield a seller or licensee who conceals or lies about a known latent defect. The licensee also must not answer beyond his knowledge — "the roof is fine" is a statement of fact, and an unverified one invites liability.

Stigmatized properties are affected not by a physical defect but by an event or reputation — a murder, a suicide, a death on the premises, or a notorious former owner. States treat them differently: many have statutes declaring that such facts are not material and need not be disclosed, some require truthful answers if a buyer asks directly, and a licensee should learn the rule in his own state before the question arises. Under the federal Fair Housing Act, HIV and AIDS are treated as disabilities, so a licensee should not volunteer or answer whether a past occupant had either. Other disclosures come from law or practice. A property in a FEMA-mapped **special flood hazard area** must carry flood insurance if the loan is from a federally regulated or insured lender, and many states require sellers to disclose flood-zone status or past flooding. Pending or levied **special assessments** — for a new sewer line or sidewalks — and owners'-association dues and rules must be disclosed and are often prorated at closing. A **home warranty** is a service contract, commonly for one year, purchased by the seller or the buyer to cover repair of systems and appliances; it is not insurance against pre-existing conditions and does not replace disclosure.

One disclosure is federal and identical in every state. Under the Residential Lead-Based Paint Hazard Reduction Act of 1992 and the rules of the EPA and HUD, sellers and landlords of most **housing built before 1978** must, before the buyer or tenant is obligated: disclose any known lead-based paint and lead hazards; provide any available records and reports; give the EPA pamphlet *Protect Your Family From Lead in Your Home*; include a **Lead Warning Statement** and the disclosure in the contract or lease; and, for buyers, offer a **10-day opportunity** to conduct a risk assessment or inspection — a period the parties may lengthen, shorten or waive in writing. Tenants do not receive the 10-day testing period. The seller, the landlord and their agents must keep signed copies of the disclosure for three years. Agents have their own duty: they must inform the seller or landlord of these obligations and ensure compliance, and they share liability if the disclosure is not made. Remember the cross-reference to Lesson 3.5: the rule requires *disclosure* of known lead hazards, not

testing or removal. Recall too the earlier environmental hazards — radon, mold, asbestos, underground tanks — whose known presence is a material fact.

On the exam today. Disclosure questions are scenarios. The traps: a seller's agent must disclose known material latent defects to the buyer — confidentiality and loyalty to the seller never cover a defect; an *"as is"* clause does not excuse concealment of a known latent defect; a *patent* defect the buyer could see is generally the buyer's risk, but lying about it is still misrepresentation; licensees are liable for what they knew or *should have known*, so red flags call for investigation and an inspection recommendation; stigmatized-property rules vary by state; and the lead-based paint rule applies to housing built *before 1978*, requires the EPA pamphlet and warning statement, gives *buyers* (not tenants) a 10-day testing opportunity that may be waived, and requires records kept three years. When a stem asks what the licensee should do on seeing a stain or crack, the answer is to disclose what was observed and recommend a professional inspection — not to repair it, explain it away or stay silent.

PICTURE STUDY



The Little Street, Johannes Vermeer, c. 1658 · Oil on canvas · Rijksmuseum, Amsterdam

Image: Wikimedia Commons, public domain

Johannes Vermeer of Delft painted only about three dozen pictures that survive, and this is one of only two views of his town. Around 1658 he painted the front of an ordinary old house so exactly that scholars have since identified its likely address on a Delft canal. He did not tidy it up. The brick is cracked; mortar has been patched; the lower walls are whitewashed over old repairs; a crack runs up the gable. Everything wrong with the front of this house is visible to anyone who looks — a painting of patent defects, and a reminder of how much an honest look can tell, and how much it can't.

Look closely

- Trace the cracks in the brick of the upper gable and around the windows. These are patent defects — visible to any buyer who stops to look.
- Find the whitewashed patches on the lower walls. Paint over brick can protect it — or hide what is underneath. A careful buyer asks which.
- Look through the open passage at the left to the woman in the courtyard. Some of a house's story is behind the facade, out of sight from the street.
- Notice the woman sewing in the doorway and the children at play. Vermeer's house is cracked, but it is cared for and lived in — condition and value are not the same thing.

Talk about it

1. Which conditions in this painting would you call patent defects? What might be hidden behind the whitewash that a seller would have to disclose if he knew of it?
2. If you were the listing agent for this house, what would you recommend to a buyer before signing?
3. Proverbs says that those who "deal truly" are the LORD's delight. Why is it harder to tell the truth about a house you are trying to sell — and why does it matter more?

PROJECT

The Disclosure Walk-Through

In this project you will learn to see a house the way a careful licensee does — not as an inspector, but as someone who notices red flags and knows what must be said about them. Using your state's official seller disclosure form, you will complete a disclosure walk-through of your own home with a parent (or of a pretend house if your family prefers privacy), then write the disclosure notes a seller would give a buyer, and finish with a lead-paint checklist.

You will need

- Your state's official seller property condition disclosure form, from the real estate commission or the state code (for study only)
- The EPA page on real estate disclosures about lead (listed in this unit's resources)
- Exam notebook, pencil and a flashlight

Steps

1. Read your state's disclosure form and list its main sections (structure, roof, water, sewer or septic, environmental, legal). Note any exempt transfers the statute lists, with the citation and date.
2. With a parent's permission, walk your home (or a pretend house) with the form. In each section, record visible conditions only — stains, cracks, odors, sloping floors, old repairs — without guessing at causes.
3. For each item, write P (patent — a buyer could see it) or L (latent — known to the family but hidden), and mark which latent items the seller would have to disclose.
4. List three red flags you found, and for each write the professional you would recommend (home inspector, structural engineer, roofer, septic contractor, surveyor).
5. Complete a lead-paint checklist: year built; whether the rule applies; the five steps the seller must take; the 10-day testing period and how it may be waived; the three-year record rule.

6. Write a one-paragraph note on how your state treats stigmatized properties, with the citation.
7. Title the file "Disclosure Walk-Through," date it and add it to your Pathway File; keep any private family details out of the copy you share.

EXAM NOTEBOOK

1. Make flashcards for every key term, with latent and patent defects on one card and an example of each.
2. Draw a disclosure decision tree: Is it material? → Is it known (or should it be)? → Disclose and recommend inspection. Add a side branch for stigmatized property (check state law).
3. Write a trap list titled "Disclosure": seller's agent must disclose known defects to buyers; "as is" doesn't excuse concealment; red flags → inspection; lead paint pre-1978, pamphlet, warning, 10 days for buyers only, 3 years of records; stigma rules vary by state.

> **From history.** The Latin phrase *caveat emptor* is often thought to be ancient, but Roman law was in fact kinder to buyers: the edicts of the Roman market officials, the *aediles*, required sellers of slaves and livestock to declare known defects and let buyers return goods with hidden flaws. The strict English rule of "buyer beware" grew up much later in the common law, and it is the modern disclosure statutes, not the Romans, that have finally put it to rest for homes.

Example 1. Exam style. A seller tells his listing agent that the septic system backs up every winter but works fine in summer. It is July. The seller asks the agent not to mention it, and the house is listed "as is." A buyer asks, "Any problems with the septic?" The agent should:

A. Say nothing, because the house is sold as is

B. Answer that it is working fine now, which is true

C. Disclose the winter backups and recommend a septic inspection

D. Keep the information confidential, because the seller is the agent's client

Show solution

1. Identify the fact: a recurring septic failure is a material, latent defect — not visible in July.
2. The agent knows it, so license law and the common law require disclosure to the buyer, regardless of representation.
3. "As is" does not excuse concealment of a known latent defect (A); a technically true half-truth meant to mislead is misrepresentation (B); confidentiality does not cover defects (D).
4. The agent should also tell the seller the defect must appear on the disclosure statement, and withdraw if the seller insists on hiding it.

Answer: C. Disclose the known defect and recommend a professional septic inspection.

Example 2. A house built in 1962 is for sale. The seller has an old report showing lead-based paint on the exterior trim. Walk through what federal law requires before the buyer is bound, and what the agent must do.

Show solution

1. Built before 1978, so the lead-based paint disclosure rule applies.
2. The seller must disclose the known lead-based paint, provide the old report, give the EPA pamphlet *Protect Your Family From Lead in Your Home*, and include the Lead Warning Statement and disclosure in the contract.
3. The buyer must be offered a 10-day opportunity to conduct a risk assessment or inspection, which the parties may change or waive in writing.
4. The agent must tell the seller of these duties and ensure compliance; the seller and agent keep signed copies for three years.
5. Nothing in the rule requires the seller to remove the paint — only to disclose.

Answer: Disclose the known paint and the report, give the EPA pamphlet, include the warning statement, offer a 10-day testing opportunity, and keep records three years; the agent ensures it all happens.

Example 3. Three disclosure questions arrive in one afternoon: (a) a buyer asks whether anyone died in the house (the prior owner died peacefully there last year); (b) a buyer asks whether the prior owner had AIDS; (c) a buyer notices a large diagonal crack in the basement wall and asks what it means. How should the listing agent handle each?

Show solution

1. (a) Stigmatized-property rules vary by state. Many states say such a death is not material and need not be volunteered; some require a truthful answer to a direct question. The agent follows the state statute and never lies.
2. (b) HIV and AIDS are disabilities under the federal Fair Housing Act; the agent should not disclose or answer about an occupant's HIV or AIDS status.
3. (c) The crack is a patent condition and a red flag. The agent should share any known information, avoid guessing at the cause, and recommend a structural or general home inspection.
4. In every case, the agent may decline to answer only where the law permits — never by making a false statement.

Answer: (a) Follow the state's stigmatized-property statute, without lying; (b) do not disclose; (c) share what is known and recommend a professional inspection.

PRACTICE

1. Easy What does caveat emptor mean, and is it still the general rule for residential sales?

   Show answer

   "Let the buyer beware." It is no longer the general rule for homes: most states require seller disclosure of known material defects, and licensees must disclose known defects to buyers.

2. Easy Distinguish a latent defect from a patent defect, with an example of each.

   Show answer

   A latent defect is hidden and would not be found on reasonable inspection, like a cracked slab under carpet; a patent defect is visible on reasonable inspection, like a broken window.

3. **Easy** Which homes are covered by the federal lead-based paint disclosure rule?

Show answer

Most housing built before 1978, whether sold or leased.

4. **Medium** A listing agent represents the seller. Must she tell a buyer about a cracked foundation the seller told her about privately?

Show answer

Yes. A known material latent defect must be disclosed to buyers even by the seller's agent. Confidentiality protects the seller's motives and price, not defects in the property.

5. **Medium** A house is sold "as is." After closing, the buyer discovers the seller had hidden known termite damage behind new paneling. Does the "as is" clause protect the seller?

Show answer

No. "As is" means the buyer accepts conditions he could see or discover, but it does not shield active concealment or fraud about a known latent defect.

6. **Medium** List the five main steps a seller must take under the federal lead-based paint rule before a buyer is obligated.

Show answer

Disclose known lead-based paint and hazards; provide available records and reports; give the EPA pamphlet; include the Lead Warning Statement and disclosure in the contract; and offer the buyer a 10-day opportunity to test (which may be changed or waived in writing).

7. **Medium** What is a home warranty, and does it replace the seller's duty to disclose?

Show answer

A service contract, commonly for one year, covering repair or replacement of home systems and appliances that fail from normal use. It does not replace disclosure, and it typically excludes known pre-existing conditions.

8. Hard During a listing appointment, an agent notices a freshly painted square on one ceiling, a dehumidifier in the basement and a musty smell. The seller's disclosure form says "no water problems." What should the agent do?

Show answer

Ask the seller about the observations, explain that known water problems must be disclosed, and note what she observed. Because licensees may be liable for what they should have known, she should not repeat the seller's "no water problems" as her own statement, and should recommend that buyers obtain a professional inspection.

9. Hard A tenant is renting a 1950s apartment. Which parts of the lead-based paint rule apply, and which do not?

Show answer

The landlord must disclose known lead-based paint and hazards, provide available records, give the EPA pamphlet and include the warning statement in the lease, and keep records for three years. The 10-day testing opportunity applies only to buyers, not tenants.

10. Hard A buyer's lender says the house is in a special flood hazard area. What does that mean for the loan, and why is it a material fact?

Show answer

A FEMA-mapped special flood hazard area has a 1% annual chance of flooding, and federally regulated or insured lenders require flood insurance on the loan. Flood risk and the cost of insurance affect value and affordability, so the zone is a material fact that many states require sellers to disclose.

11. Challenge Compare the rules of Laidlaw v. Organ (1817) and Johnson v. Davis (1985). What changed, and what stayed the same?

Show answer

Laidlaw held that a buyer need not disclose outside market information he knew, so long as he did not lie — caveat emptor. Johnson held that a home seller must disclose known facts materially affecting value that are not readily observable. What stayed the same is the prohibition on lies and active concealment; what changed is that silence about a known latent defect in a home is no longer allowed.

12. **Challenge** A buyer asks a listing agent, “Did anything bad ever happen in this house?” The agent knows a crime occurred there years ago, and her state’s statute says such events are not material and need not be disclosed. What may she say, and what may she never say?

Show answer

She may follow the statute and decline to discuss it — for example, “State law doesn’t treat events like that as material, and I’d suggest you do any research you wish” — if the statute permits that answer. She may never make a false statement such as “No, nothing ever happened here,” because an affirmative lie is misrepresentation regardless of the disclosure statute.

COMMON MISTAKES

- Thinking a seller’s agent may keep a known defect confidential for the client. Known material defects must be disclosed to buyers.
- Believing an “as is” clause excuses hiding a known latent defect. It does not cover concealment or fraud.
- Treating stigmatized-property rules as uniform. They vary by state, and the licensee must learn his own state’s statute.
- Giving tenants the 10-day lead testing period. It applies to buyers only.
- Thinking the lead rule requires testing or removal. It requires disclosure, the pamphlet, the warning statement and an opportunity to test.
- Explaining away a red flag instead of recommending a professional inspection.

> **Make it a game · Tell or Don’t Tell?.** Make twenty condition cards: “roof leaks in heavy rain,” “broken window anyone can see,” “seller painted over a water stain,” “a death from natural causes last year,” “house built in 1965, lead paint report on file,” “new sewer special assessment voted last month,” “the house is in a FEMA flood zone.” Players take turns drawing a card and answering TELL, DON’T TELL or CHECK STATE LAW, plus what the licensee should recommend. A correct call scores a point; naming the right recommendation (inspection, EPA pamphlet, flood insurance, survey) scores a bonus. Most points after twenty cards wins.

> **Scripture.** “Lying lips are abomination to the LORD: but they that deal truly are his delight.” (Proverbs 12:22, KJV)
>
> Disclosure law is, at bottom, a legal form of this proverb. A seller or licensee who hides a known defect to close a sale deals falsely, however quietly; one who tells the truth about a leaking roof or a cracked foundation may lose a buyer, but deals truly. Scripture says that kind of honesty is not merely prudent — it is the LORD’s delight.

UNIT 8

Agency and Disclosure

In 1983 a federal survey found that most home buyers believed the agent who drove them from house to house was working for them — when, under the rules of the day, that agent legally represented the seller. This unit is about the question those buyers never thought to ask: *whom does this agent work for, and what does he owe me?* Together with contracts, it is the heaviest part of the national exam. You will learn the cast of every transaction — **principal**, **agent**, **customer** — and how an agency is created and ended. You will learn the **fiduciary duties** an agent owes a client, remembered as OLD CAR, through a New York case in which a judge held a business partner to "the punctilio of an honor the most sensitive." You will study the **listing agreement** in its four forms, work the commission arithmetic, and learn why every commission is negotiable and why fixing one is a federal offense.

Then you will turn to the buyer's side: **buyer representation agreements** and the written agreement required before touring as of 2026, **dual agency** and its limits, designated agency and the transaction broker, and the disclosure that must come first. The unit closes with what every licensee must say about the house itself — **material facts**, **latent defects**, stigmatized properties and the federal lead-based paint rule — and the long road from *caveat emptor* to the disclosure statement. Read each scenario asking two questions: who is the client, and what does the truth require?

PREREQUISITES

- Can explain the elements of a valid contract and the difference between bilateral and unilateral contracts, from Lesson 7.1
- Can explain earnest money, trust accounts and the handling of multiple offers, from Lesson 7.3
- Can compute a percentage of a number and a share of a share (for example, 60% of half of 5% of a price)
- Has the exam notebook current, with the environmental hazards from Lesson 3.5 ready for review

MASTERY CHECKLIST

- ☐ I can identify the principal, agent and customers in any transaction and classify an agent as universal, general or special.
- ☐ I can explain how agency is created and terminated, and why compensation does not determine agency.
- ☐ I can name and apply the six fiduciary duties of OLD CAR and the duties owed to customers.
- ☐ I can distinguish puffing, negligent and intentional misrepresentation, and fraud, and identify a secret profit.
- ☐ I can tell the four listing types apart, explain protection clauses and procuring cause, and compute commission splits.
- ☐ I can explain that commissions are negotiable, that fixing them is illegal, and the 2024 MLS rules on compensation offers and written buyer agreements.
- ☐ I can explain dual, designated and transaction-broker relationships, the consent dual agency requires, and when agency must be disclosed.

- ☐ I can decide what must be disclosed about a property, including latent defects, stigmatized-property rules and the lead-based paint requirements for pre-1978 housing.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Washington State Legislature: RCW 18.86.120, the Pamphlet on the Law of Real Estate Agency**: Free, official. The full text of the agency pamphlet Washington brokers must give buyers and sellers, a clear plain-language statement of the duties owed to clients and to all parties. Read it with Lessons 8.2 and 8.4, then find your own state's version. Ages 15 and up.
- **EPA: Real Estate Disclosures about Potential Lead Hazards**: Free, official. The Environmental Protection Agency's page on the federal lead-based paint disclosure rule for sales and leases of pre-1978 housing, with the required pamphlet and sample disclosure forms. Use it for Lesson 8.5's project. Ages 14 and up.
- **Legal Information Institute (Cornell Law School): Agency**: Free. A law-school encyclopedia entry on the law of agency — principals, agents, authority and fiduciary duty — with links to related doctrines. A second explanation for Lessons 8.1 and 8.2. Ages 15 and up.
- **FEMA Flood Map Service Center**: Free, official. Look up the official flood map for any address and read its flood zone. Use it for the extension in Lesson 8.5 with a public landmark rather than a private home. Ages 14 and up.
- **Consumer Financial Protection Bureau: Buying a House**: Free, official. The federal consumer bureau's step-by-step guide for home buyers, including working with a real estate professional and reviewing disclosures. Skim it with Lesson 8.4 to see agency from the buyer's chair. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

8.1	**What Agency Is: Principals, Agents and Customers**	3 sessions of 50 minutes
8.2	**The Fiduciary Duties**	3 sessions of 50 minutes

8.3	**Listing Agreements**	3 sessions of 50 minutes
8.4	**Buyer Agency, Dual Agency and Other Relationships**	3 sessions of 50 minutes
8.5	**Property Disclosures and Material Facts**	3 sessions of 50 minutes

Unit 8 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Commission rates and other figures marked “in this example” are examples only — commissions are always negotiable, and disclosure and agency rules vary by state. A score of 70% (14 of 20) matches the common passing line on the national exam, but aim higher. For each scenario, first decide who is the client, then choose the one BEST answer.

1. **5 pts**

   A broker who is hired under a listing agreement to find a buyer for one house is a:

   A. Universal agent

   B. General agent

   C. Special agent

   D. Subagent

2. **5 pts**

   A buyer’s broker is paid at closing from a concession the seller agreed to make. Whom does the buyer’s broker represent?

   A. The buyer

   B. The seller, who is paying

   C. Both parties as a dual agent

   D. Neither party

3. 5 pts

All of the following terminate an agency by operation of law EXCEPT:

A. Death of the principal

B. Destruction of the property

C. Bankruptcy of the principal

D. Expiration of the listing term

4. 5 pts

A broker, acting without authority, negotiates an offer on an owner's vacant lot. The owner accepts the offer and agrees at closing to pay the broker's fee. The agency was created by:

A. Estoppel

B. Ratification

C. Express agreement in advance

D. Implication from the buyer's conduct

5. 5 pts

A listing agent tells a buyer, "The seller just lost his job and must sell this month — offer low." The agent has breached the duty of:

A. Obedience

B. Accounting

C. Reasonable care

D. Confidentiality

6. 5 pts

A seller instructs his agent not to show the home to a family because of their national origin. The agent should:

A. Refuse, because the instruction is unlawful under the Fair Housing Act

B. Comply, because of the duty of obedience

C. Comply, but only for the term of the listing

D. Comply, but disclose the instruction to the family

7. 5 pts

A listing agent says a house has “the most charming kitchen in the county.” This statement is BEST described as:

A. Fraud

B. Negligent misrepresentation

C. Puffing

D. Intentional misrepresentation

8. 5 pts

A licensee lists a home and, without telling the seller, arranges for her brother-in-law to buy it below market so they can resell it for a profit. Her conduct is primarily a breach of:

A. Loyalty, through an undisclosed secret profit

B. Accounting

C. Obedience

D. Nothing, if the price was the listing price

9. 5 pts

An owner lists with Broker A under an exclusive-agency listing. During the term, the owner sells to a friend he found himself. The owner owes Broker A:

A. The full commission

B. Half the commission

C. Reimbursement of advertising only, if the listing says so

D. Nothing

10. 5 pts

A house sells for $350,000. In this example, the commission is 6%, split equally between the listing and selling brokerages, and the selling agent receives 60% of her firm’s share. The selling agent earns:

A. $21,000

B. $6,300

C. $10,500

D. $12,600

11. 5 pts

Which listing type is illegal or discouraged in many states because the broker keeps everything above the seller's stated amount?

A. Net listing

B. Open listing

C. Exclusive agency

D. Exclusive right to sell

12. 5 pts

Who sets the commission rate in a residential listing?

A. The state real estate commission

B. The local MLS

C. The broker and the seller, by negotiation

D. The national association of brokers

13. 5 pts

A listing expires June 30. It contains a 90-day protection clause, and the broker gave the seller a written list of buyers he showed the home. On August 15 the seller, who has not relisted, sells to a buyer on that list. The broker:

A. Is owed nothing, because the listing expired

B. Is owed the commission under the protection clause

C. Is owed half the commission

D. Must sue for procuring cause instead

14. 5 pts

As of 2026, under MLS rules adopted in August 2024, which statement is correct?

A. Listing brokers must publish offers of compensation on the MLS

B. Buyers may tour homes with an agent and sign an agreement only at closing

C. Buyer-broker commissions are set by the MLS

D. A licensee working with a buyer must have a written agreement with the buyer before touring a home

15. 5 pts

One brokerage represents both the buyer and the seller in the same transaction with both parties' informed written consent. The brokerage may:

A. Tell the seller the buyer will pay more than offered

B. Disclose to the buyer a known leak in the basement

C. Advise the buyer to offer less than list price

D. Tell the buyer the seller's lowest acceptable price

16. 5 pts

A brokerage's managing broker appoints one licensee to represent the seller and a different licensee to represent the buyer in an in-house sale. This arrangement is:

A. Undisclosed dual agency

B. Subagency

C. Designated agency

D. Transaction brokerage

17. 5 pts

A buyer's written agreement sets her broker's fee at 2.5% of the price in this example. She buys a $400,000 home, and the seller agrees to a concession of $7,000 toward the fee. If no other source pays, the buyer owes her broker:

A. $3,000

B. $10,000

C. $7,000

D. $0

18. 5 pts

A seller's agent knows the house's septic system fails every winter. The listing is in July, and the house is offered "as is." The agent must:

A. Say nothing, because the sale is as is

B. Disclose the defect to buyers, because it is a known material latent defect

C. Disclose it only if the buyer asks about the septic system

D. Keep it confidential for the seller

19. 5 pts

Under the federal lead-based paint rule, a buyer of a home built in 1965 must be given:

A. A free lead inspection paid by the seller

B. Removal of all lead-based paint before closing

C. A 30-day right to rescind after closing

D. A 10-day opportunity to test, which may be changed or waived in writing

20. 5 pts

A licensee showing a home notices a fresh patch of paint on one ceiling and a musty odor in the basement. The seller says there are no problems. The licensee should:

A. Disclose what was observed and recommend a professional inspection

B. Repaint the patch so it matches

C. Assure the buyer the house is sound, as the seller said

D. Say nothing, because the seller completed the disclosure form

ANSWER KEY

1. C. A listing broker is authorized for one specific transaction and generally cannot bind the seller — a special agent. A property manager is the classic general agent.
2. A. Compensation does not determine agency; the buyer representation agreement does. The broker owes fiduciary duties to the buyer.
3. D. Expiration ends an agency by the terms the parties set — an act of the parties. Death, destruction and bankruptcy end it by operation of law.
4. B. Accepting the benefits of an unauthorized act approves it after the fact — ratification. Estoppel arises when a principal leads a third party to believe someone is his agent.
5. D. The seller's financial situation and urgency are confidential information the agent must protect from the other side. It is also disloyal.
6. A. Obedience covers lawful instructions only. Refusing to show because of national origin violates the Fair Housing Act; the agent must refuse and withdraw if the seller insists.
7. C. An exaggerated opinion that a reasonable buyer would not take as fact is puffing, generally not actionable. Misrepresentation concerns false statements of fact.
8. A. Placing her own interest above the client's and concealing her relationship to the buyer is a breach of loyalty (and disclosure); the resale gain is a secret profit.
9. D. In an exclusive-agency listing the owner reserves the right to sell himself without a commission. Under an exclusive right to sell, A would be owed the full commission.
10. B. Total $\$350{,}000 \times 0.06 = \$21{,}000$; firm share \$10,500; agent $\$10{,}500 \times 0.60 = \$6{,}300$. D takes 60% of the whole commission.
11. A. A net listing creates a conflict of interest — the broker profits from an underpriced net — so many states ban or discourage it.
12. C. Commissions are always negotiable between the brokerage and its client. Any rate set by a commission, MLS or association would be illegal price fixing.
13. B. The sale occurred within the protection period, to a buyer the broker introduced, and the seller had not relisted with another broker.
14. D. A written buyer agreement is required before touring, and offers of compensation are not published on the MLS. Commissions remain negotiable

and are not set by any MLS.

15. B. A dual agent must stay neutral and protect each party's confidential price and motivation, but must still disclose known material defects.
16. C. In designated agency, each appointed licensee represents his own client fully; where permitted, it requires the disclosures and consents the state prescribes.
17. A. Fee $\$400{,}000 \times 0.025 = \$10{,}000$; minus the $7,000 concession leaves $3,000, unless the agreement provides otherwise.
18. B. Known material latent defects must be disclosed even by the seller's agent; an "as is" clause does not excuse concealment, and confidentiality never covers defects.
19. D. The rule requires disclosure of known lead paint, records, the EPA pamphlet, a warning statement and a 10-day testing opportunity for buyers. It does not require testing or removal by the seller.
20. A. Red flags call for disclosure of what the licensee observed and a recommendation of a professional inspection. Vouching for the house invites liability for what the licensee should have known.

PORTFOLIO PIECE: MY PATHWAY FILE — THE AGENCY PAGES

Assemble the agency and disclosure section of your Pathway File: the Relationship Map with its four diagrams and your state's agency-disclosure note (8.1); the OLD CAR Casebook with twelve solved cases and your "How I Will Practice" statement (8.2); the Listing Desk with its four listings, commission calculator and protection-clause checker (8.3); the Relationship Disclosure Packet with your state's pamphlet summary, the pretend buyer-agreement summary, the fee worksheet and the dual-agency script (8.4); and the Disclosure Walk-Through with its patent and latent list, red flags, lead-paint checklist and stigmatized-property note (8.5).

Close the section with a one-page letter to a pretend first client, written in your own voice, explaining whom you will represent, what you will owe them under OLD CAR, how you are paid and that the fee is negotiable, what you will never keep secret about a property, and why you will tell them the truth about a house even when it costs you a sale. Quote Proverbs 12:22. Date every page; Unit 9 builds on these artifacts with fair housing, advertising and the practice of a brokerage.

LOOK FOR	WHAT IT MEANS
Relationship Map	Every person in all four transactions is correctly labeled client, customer or agent; each agent is classified universal, general or special with the method of creation; and the state disclosure rule is cited and dated.
OLD CAR Casebook	All twelve cases name the right duty and give a workable correct response; the customer cases distinguish puffing from misrepresentation; the practice statement is honest and specific.
Listing Desk	Each listing story pays the right broker; the calculator reproduces $24,000, $12,000 and $8,400 with every rate labeled an example; the protection-clause checker handles relisting correctly.
Relationship Disclosure Packet	The state's relationships are explained accurately in plain language; the buyer agreement summary states compensation, the cap and that fees are negotiable; the worksheet returns $2,100 and $10,500; the script obtains informed written consent.
Disclosure Walk-Through	Patent and latent items are correctly classified, each red flag is paired with the right professional, and the lead-paint checklist and stigmatized-property note are accurate, cited and dated, with private family details kept out of shared copies.

LOOK FOR	WHAT IT MEANS
Letter to a first client	Written in the student's own voice, it explains representation, the fiduciary duties, negotiable compensation and the duty to disclose defects accurately, and connects Proverbs 12:22 to honest dealing without canned language.

UNIT 9

The Practice of Real Estate

On April 11, 1968, a law was signed that changed the working day of every real estate office in America, and it still governs yours. This unit is about that working day — the rules that apply not to one contract or one property but to everything a licensee does. You will begin with the **Fair Housing Act** and the far older **Civil Rights Act of 1866**: the seven federal protected classes, the narrow exemptions, and the practices the law forbids by name — **steering**, **blockbusting**, **redlining** and discriminatory advertising. You will learn what the law requires for residents with disabilities — the difference between a **reasonable modification** and a **reasonable accommodation**, the design rules for apartments built since 1991, and the **Americans with Disabilities Act** in your own office.

Then you will turn to money and management. The **Sherman Antitrust Act** explains why commissions are always negotiable and never agreed among competitors, and the law of **trust accounts** explains why a buyer's earnest money must never touch the broker's own bank account. You will see how a brokerage is supervised, why most agents are **independent contractors**, what an unlicensed assistant may do, how the Do Not Call Registry and email law shape prospecting, and how to stop a wire-fraud scheme before a family loses its down payment. The unit ends with **property management** — the management agreement, budgets, maintenance and risk — and the arithmetic of a building that must pay its way.

PREREQUISITES

- Can define agent, principal, client and customer, and list the fiduciary duties, from Unit 8
- Can explain earnest money and its role in a purchase agreement, from Lesson 7.3
- Can compute effective gross income and net operating income, from Lesson 4.5
- Has the exam notebook current, with the Unit 8 trap lists ready for review

MASTERY CHECKLIST

- ☐ I can name the seven federal protected classes with their dates and explain how the Civil Rights Act of 1866 and *Jones v. Alfred H. Mayer Co.* add a rule with no exemptions.
- ☐ I can identify steering, blockbusting, redlining, misrepresenting availability and discriminatory advertising in a scenario, and apply the four Fair Housing Act exemptions correctly.
- ☐ I can tell a reasonable modification from a reasonable accommodation, say who pays, and state which multifamily units must meet the design and construction requirements.
- ☐ I can recognize price fixing, group boycotting, market allocation and tie-in arrangements, and explain why commissions are always negotiable.
- ☐ I can distinguish commingling from conversion, reconcile a trust account, and describe how a

broker handles disputed earnest money.

- ☐ I can state the three requirements for statutory nonemployee status and sort tasks an unlicensed assistant may and may not perform.
- ☐ I can apply the Do Not Call, TCPA and CAN-SPAM rules to prospecting and explain how to prevent wire fraud at closing.
- ☐ I can describe the management agreement, the maintenance types, the three budgets and ACTS, and compute a management fee, a vacancy rate and NOI.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **HUD: Fair Housing Act Overview**: Free, official. The Department of Housing and Urban Development's plain-language summary of what the Act covers, the protected classes, the exemptions and how to file a complaint. Use it with Lessons 9.1 and 9.2 and for the extension on your desk reference. Ages 15 and up.
- **U.S. Department of Justice: The Fair Housing Act**: Free, official. The Civil Rights Division's page on the Act it enforces through pattern-or-practice suits, with a clear section on disability and the design and construction requirements. Read it with Lesson 9.2. Ages 15 and up.
- **ADA.gov: Title III — Businesses and Nonprofits**: Free, official. The Justice Department's guide to the ADA's public-accommodation rules, including barrier removal in existing buildings. Use it during Lesson 9.2 to see what a brokerage office must do. Ages 15 and up.
- **U.S. DOJ Antitrust Division: Price Fixing, Bid Rigging, and Market Allocation Schemes**: Free, official. The Antitrust Division's primer on the agreements it prosecutes and how to recognize them. Read it with Lesson 9.3 before writing your safe-talk card. Ages 15 and up.
- **IRS: Independent Contractor (Self-Employed) or Employee?**: Free, official. The IRS's page on worker classification, with links to the rules for statutory nonemployees. Use it with Lesson 9.4's compliance binder. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

9.1	**Fair Housing: The Law and Its History**	3 sessions of 50 minutes
9.2	**Accessibility, Accommodations and Fair Treatment**	3 sessions of 50 minutes
9.3	**Antitrust and Other People's Money**	3 sessions of 50 minutes
9.4	**Running a Lawful Brokerage**	3 sessions of 50 minutes
9.5	**Property Management**	3 sessions of 50 minutes

Unit 9 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Seventy percent — 14 of 20 — matches the common passing line, but aim higher. Figures marked “in this example” are examples; real deadlines, fees and penalties are checked with HUD, the FTC or your state commission. Choose the one BEST answer.

1. **5 pts**

   Which of the following is NOT one of the seven protected classes under the federal Fair Housing Act?

   A. Familial status

   B. Marital status

   C. National origin

   D. Handicap

2. **5 pts**

   The Civil Rights Act of 1866, as applied in *Jones v. Alfred H. Mayer Co.*, prohibits discrimination in the sale or rental of property based on:

   A. Religion

   B. Sex

   C. Familial status

   D. Race

3. **5 pts**

   A licensee goes door to door telling owners that families of a certain national origin are moving onto the street and that they should list now before values fall. This is:

   A. Blockbusting

   B. Steering

   C. Redlining

   D. A tie-in arrangement

4. 5 pts

The “Mrs. Murphy” exemption from the Fair Housing Act applies to:

A. Any single-family home sold by its owner

B. Any building of six units or fewer

C. Rooms or units in an owner-occupied dwelling of four or fewer units, with no broker and no discriminatory advertising

D. Any rental housing owned by a religious organization

5. 5 pts

A renter believes she was refused an apartment because she is pregnant. Within what period must she file a complaint with HUD?

A. 180 days

B. One year

C. Two years

D. Three years

6. 5 pts

A tenant who uses a wheelchair asks to install grab bars in the bathroom of his privately owned apartment. Who generally pays for the grab bars?

A. The tenant

B. The landlord

C. HUD

D. The landlord and tenant equally

7. 5 pts

Which building must have accessible ground-floor units under the Fair Housing Act’s design and construction requirements?

A. A triplex first occupied in 2010

B. A 20-unit building first occupied in 1985

C. A single-family home built in 2020

D. An 8-unit walk-up without an elevator first occupied in 2005

8. 5 pts

A resident with a disability-related need asks to keep an assistance animal in a no-pets building. The landlord may:

A. Charge the usual pet deposit and pet rent

B. Refuse, because the no-pets policy applies to everyone

C. Grant the request without pet fees, while holding the resident liable for any actual damage

D. Require the resident to provide a full medical diagnosis

9. 5 pts

Title III of the Americans with Disabilities Act applies most directly to:

A. A real estate brokerage office open to the public

B. A single-family home sold by its owner

C. The bedrooms of an owner-occupied duplex

D. A private vacation cabin

10. 5 pts

Two brokers agree that one will take listings only north of the highway and the other only south of it. This is:

A. Price fixing

B. Market allocation

C. Group boycotting

D. A tie-in arrangement

11. 5 pts

A real estate commission rate is determined by:

A. The state real estate commission

B. The local real estate association

C. Federal law

D. Negotiation between the broker and the client

12. 5 pts

A broker deposits a buyer's earnest-money check into the brokerage's operating account to save a trip to the bank. This is:

A. Conversion

B. Interpleader

C. Commingling

D. Novation

13. 5 pts

A transaction fails, and the buyer and seller each demand the $8,000 earnest money held by the listing broker. The broker should:

A. Hold the funds in trust until a mutual written release, a court order or an interpleader decision

B. Return the money to the buyer, who paid it

C. Pay the money to the seller, the broker's client

D. Split the money equally between them

14. 5 pts

A trust account statement shows $20,000. There is a $3,000 deposit in transit and $1,200 in outstanding checks. The adjusted bank balance that should equal the total of the client ledgers is:

A. $24,200

B. $21,800

C. $18,200

D. $20,000

15. 5 pts

Which fact would DEFEAT a real estate agent's treatment as a statutory nonemployee for federal tax purposes?

A. The agent holds a real estate license

B. The agent signed a written contract stating she is not an employee

C. The agent is paid an hourly wage

D. The agent is paid only commissions on closed sales

16. 5 pts

Under federal telemarketing rules, a licensee prospecting by phone may call:

A. Between 7 a.m. and 10 p.m. the caller’s time

B. Only between 9 a.m. and 5 p.m.

C. Between 8 a.m. and 8 p.m. the caller’s time

D. Between 8 a.m. and 9 p.m. the called person’s local time

17. 5 pts

An unlicensed assistant working for a broker may generally:

A. Schedule showing appointments

B. Show a listed home to buyers

C. Discuss the price the seller might accept

D. Explain the terms of the purchase agreement

18. 5 pts

Two days before closing, a buyer receives an email that appears to be from the title company with new wiring instructions. The buyer’s agent should advise the buyer to:

A. Wire the funds immediately to avoid delaying closing

B. Reply to the email to confirm the new instructions

C. Call the title company at a known, verified number before sending any funds

D. Forward the email to the lender and then wire the funds

19. 5 pts

A manager earns 7% of rents collected. A 30-unit building rents for $1,200 per unit, and 3 units were vacant all month; all other rent was paid. The monthly fee is:

A. $2,520

B. $2,268

C. $2,160

D. $25,200

20. 5 pts

A property manager has the boilers inspected and serviced every fall before the heating season. This is:

A. Corrective maintenance

B. Construction maintenance

C. Routine maintenance

D. Preventive maintenance

ANSWER KEY

1. B. The federal seven are race, color, religion, national origin, sex, familial status and handicap. Marital status appears in the Equal Credit Opportunity Act and in many state laws, but not on the federal fair-housing list.
2. D. The 1866 Act protects the right of all citizens to buy and rent property on the same terms as white citizens — race, with no exemptions. The other classes come from the 1968 Act and its amendments.
3. A. Inducing owners to sell for profit by suggesting a protected class is moving in is blockbusting, or panic peddling. Steering limits a buyer's choices; redlining is done by lenders and insurers.
4. C. The owner must live in a building of four or fewer units, and the exemption is lost if a broker or a discriminatory ad is used. A describes a different, narrower exemption.
5. B. A HUD complaint must be filed within one year of the violation; a private lawsuit may be filed within two years. Pregnancy is protected under familial status.
6. A. A reasonable modification — a physical change — is made at the resident's expense in private housing, and the landlord may not refuse it. B confuses a modification with an accommodation.
7. D. The rules cover buildings of four or more units first occupied after March 13, 1991; without an elevator, the ground-floor units are covered. A is too small, B too old and C is not multifamily.
8. C. Allowing the animal is a reasonable accommodation; an assistance animal is not a pet, so no pet fees, but the resident remains responsible for damage. Demanding a diagnosis is not allowed.
9. A. Title III covers places of public accommodation and commercial facilities, such as brokerage and leasing offices. Dwellings are governed by the Fair Housing Act instead.
10. B. Competitors dividing a market by territory is market allocation, illegal under the Sherman Act. Price fixing concerns agreed prices; a boycott is a joint refusal to deal.
11. D. Commissions are always negotiable and are never set by law or by any association; competitors agreeing on rates is price fixing.
12. C. Mixing client funds with the broker's own funds is commingling. Conversion would be using the money for the broker's own purposes.

13. A. The broker is a stakeholder and may not decide the dispute; the funds stay in trust until both parties agree in writing or a court decides, often through interpleader. C favors the client but violates the broker's duty as holder of trust funds.
14. B. $\$20{,}000 + \$3{,}000 - \$1{,}200 = \$21{,}800$. A adds the outstanding checks instead of subtracting them.
15. C. Statutory nonemployee status requires a license, pay based on output rather than hours, and a written contract. An hourly wage is pay for time, not output.
16. D. Telemarketing calls are limited to 8 a.m. to 9 p.m., measured at the location of the person called, and numbers on the Do Not Call Registry may not be called without an exception.
17. A. Clerical tasks such as scheduling are permitted. Showing property, discussing price and explaining contract terms are activities that require a license.
18. C. Changed wiring instructions by email are the signature of wire fraud; they must be verified by phone with a number already known to belong to the closing agent. Replying to the email (B) reaches the criminal.
19. B. Collected rent is $27 \times \$1{,}200 = \$32{,}400$, and $\$32{,}400 \times 0.07 = \$2{,}268$. A computes the fee on potential rent, which the manager did not collect.
20. D. Scheduled work that keeps equipment from failing is preventive maintenance. Corrective maintenance happens after a breakdown; construction maintenance changes or adds to the property.

PORTFOLIO PIECE: MY PATHWAY FILE — THE PRACTICE PAGES

Assemble the practice section of your Pathway File: the Fair Housing Desk Reference with its seven classes and dates, exemption decision tree and corrected advertising table (9.1); the Accessibility Checklist tested on a real floor plan and the Request Log for a pretend twelve-unit building (9.2); the Trust Account Workbook with its journal, three client ledgers, three-way reconciliation and the planted error you found, together with your Safe Talk Card on commissions (9.3); the five-page Brokerage Compliance Binder for your pretend firm, from supervision chart to wire-fraud warning letter (9.4); and the Property Management Plan for a pretend 24-unit building, with term sheet, rent survey, operating budget, maintenance calendar and risk matrix (9.5).

Close the section with a one-page letter to a pretend new agent joining your pretend firm. In your own words, explain the three promises every licensee makes to the public — to treat every person fairly, to handle other people's money as a trust, and to stay within the law and one's competence — and connect them to Leviticus 19:34 and Luke 16:10. Date every page.

LOOK FOR	WHAT IT MEANS
Fair Housing Desk Reference	All seven federal classes appear in statute order with correct dates; the decision tree places the 1866 Act, the licensee rule and the advertising rule before the four exemptions; every corrected ad line describes the property, not the people.
Accessibility pages	The seven design requirements are listed and honestly applied to a real floor plan; each of the five logged requests is correctly classified as a modification or accommodation with the right payer and a defensible decision.
Trust Account Workbook	Journal, ledgers and reconciliation agree to the penny after the planted error is found and corrected; earned fees leave the trust account; the Safe Talk Card never implies a standard or agreed commission.
Brokerage Compliance Binder	The supervision chart, contractor checklist, assistant task list and prospecting rules are accurate and complete, and the wire-fraud letter tells a buyer exactly how to verify instructions.
Property Management	The rent survey is reasoned from comparables; the operating budget computes EGI and NOI correctly with debt service

LOOK FOR	WHAT IT MEANS
Plan	excluded; every maintenance task and risk is labeled with the right type and ACTS strategy.
Letter to a new agent	Written in the student's own voice, it states the three promises clearly and ties them to the two Scripture passages without canned language.

9.1 Fair Housing: The Law and Its History

OBJECTIVES

- Name the seven protected classes of the federal Fair Housing Act and state when each was added (1968; sex in 1974; handicap and familial status in 1988).
- Distinguish the Civil Rights Act of 1866 from the Fair Housing Act of 1968, and explain what *Jones v. Alfred H. Mayer Co.* (1968) decided.
- Define and identify steering, blockbusting, redlining, discriminatory advertising, misrepresenting availability and discriminatory terms in short scenarios.
- Apply the Fair Housing Act exemptions to a fact pattern and explain why no exemption survives the use of a licensee or a discriminatory advertisement.
- Describe how the law is enforced: a HUD complaint within one year, a private suit within two years, and Department of Justice pattern-or-practice cases.

> **Warm-up.** In five minutes, write two lists. List one: every word you can think of that describes a house — rooms, yard, view, garage, distance to a park. List two: words that describe the kind of people who might live there. Circle the list a lawful real estate advertisement should draw from. Keep both lists; you will grade them against the law in core idea five.

WATCH

Fair Housing (Part 2 of 3) - Prohibitive Conduct | Real Estate Exam Prep Videos

The Real Estate Classroom · 9:30

https://www.youtube.com/watch?v=R3QpnQyRWLo

> **WHEN TO WATCH**
> Watch after core idea four, pausing at each prohibited practice to write its name and a one-line example in your notebook before he gives his.

BACKUP VIDEO

Federal Acts Related to Fair Housing | Real Estate Exam Prep

PrepAgent · 4:15

https://www.youtube.com/watch?v=zW5PCVC4-e4

A short animated review of the 1866 Act, Jones v. Mayer, the 1968 Act and the ADA; watch it before the practice set and say each law's year aloud as it appears.

KEY TERMS

Civil Rights Act of 1866

Federal law giving all citizens the same right as white citizens to inherit, purchase, lease, sell, hold and convey real and personal property; it bars racial discrimination in property and has no exemptions.

***Jones v. Alfred H. Mayer Co.* (1968)**

Supreme Court decision holding that the 1866 Act forbids private, not just governmental, racial discrimination in the sale and rental of property.

Fair Housing Act

Title VIII of the Civil Rights Act of 1968, as amended, which prohibits discrimination in the sale, rental, financing, brokerage and advertising of dwellings because of race, color, religion, national origin, sex, familial status or handicap.

protected class

A group the law shields from housing discrimination; the federal Fair Housing Act names seven.

familial status

The presence of one or more children under 18 living with a parent, legal custodian or their designee — including a pregnant woman and a person securing legal custody of a child.

steering

Channeling buyers or renters toward or away from particular neighborhoods or buildings because of their protected class.

blockbusting (panic peddling)

Inducing owners to sell or rent, for profit, by representations about the entry or prospective entry of members of a protected class into the neighborhood.

redlining

Refusing to make loans or provide insurance, or offering worse terms, in an area because of the protected-class makeup of its residents.

“Mrs. Murphy” exemption

Fair Housing Act exemption for rooms or units in an owner-occupied dwelling of four or fewer units, lost if a broker or a discriminatory advertisement is used.

housing for older persons

Housing exempt from the familial-status rule when all residents are 62 or older, or when at least 80% of occupied units have at least one resident 55 or older and the community publishes and follows policies showing that intent.

HUD

The U.S. Department of Housing and Urban Development, the federal agency that receives, investigates and conciliates Fair Housing Act complaints.

fair housing tester

A person who poses as a home seeker to check whether housing providers treat people equally; the Supreme Court has held that a tester given false information may sue.

CORE IDEAS

The story. On April 11, 1968, President Lyndon B. Johnson signed the Civil Rights Act of 1968. Its Title VIII — ever since called the **Fair Housing Act** — had seemed headed for defeat, as an open-housing bill had been in 1966. Then, on April 4, the Reverend Dr. Martin Luther King Jr. was assassinated in Memphis, and on April 10 the House passed the Senate’s bill. The new law forbade what had been ordinary practice in much of the country: refusing to sell or rent a home because of a buyer’s race, color, religion or national origin, guiding families toward some neighborhoods and away from others, and printing ads that announced who was welcome. These practices were real and widespread, and they harmed real families — deciding where children went to school and how much a household could save in the one asset most families own. Two months later, on June 17, 1968, the Supreme Court decided *Jones v. Alfred H. Mayer Co.*, and the country learned that a far older law had reached part of the same ground a century before.

How they figured it out. In 1965 Joseph Lee Jones and his wife tried to buy a home in a subdivision in St. Louis County, Missouri, and the developer refused to sell to them because Mr. Jones was Black. The Fair Housing Act did not yet exist, so the Joneses sued under the **Civil Rights Act of 1866**, passed the year after the Civil War ended, which gives all citizens “the same right … as is enjoyed by white citizens” to inherit, purchase, lease, sell, hold and convey property. For a century that law had been read

as reaching only government action. Relying on the Thirteenth Amendment, the Supreme Court held that it bars *private* racial discrimination in the sale or rental of any property. So two laws overlap. The 1866 Act covers race and nothing else — but it has **no exemptions at all**, and a wronged buyer may sue directly in federal court. The 1968 Act covers more classes but has a few narrow exemptions. Congress widened it twice: the Housing and Community Development Act of 1974 added **sex**, and the Fair Housing Amendments Act of 1988 added **handicap** and **familial status** and strengthened HUD's enforcement.

The big idea. The federal Fair Housing Act forbids discrimination in the sale, rental, financing, brokerage and advertising of **dwellings** — any building or part of a building designed for residential use, and vacant land offered for one — because of membership in one of seven **protected classes**, listed exactly as the statute lists them: **race, color, religion, national origin, sex, familial status and handicap** (today usually called disability). Learn them with their dates: the first four in 1968, sex in 1974, familial status and handicap in 1988. **Familial status** means a household with one or more children under 18 living with a parent, a legal custodian or their designee, and it also protects a pregnant woman and a person in the process of securing custody of a child. Many states and cities add protected classes beyond the seven federal ones — such as marital status, age, source of income, military status, sexual orientation and gender identity — and federal agency interpretations have changed over time, so a licensee must learn and follow the list in their own state and city.

The exam asks you to match a scenario to its name. It is illegal to **refuse to sell, rent or negotiate**, or otherwise make a dwelling unavailable, because of a protected class; to set **different terms, conditions, privileges or services** — a larger deposit, a different rent, slower repairs; to **misrepresent availability** ("that one just rented") to keep someone from seeing a home; and to make, print or publish any **discriminatory statement or advertisement. Steering** is guiding a buyer toward or away from neighborhoods because of a protected class — even when the buyer never notices it happening. **Blockbusting**, also called **panic peddling**, is urging owners to sell, for profit, by suggesting that members of a protected class are moving in. **Redlining** is refusing loans or insurance, or offering worse terms, in an area because of who lives there; the Act forbids discrimination in all residential real estate–related transactions, including lending and appraisal. It is also illegal to deny anyone access

to an MLS because of a protected class, or to coerce, threaten or retaliate against anyone exercising fair housing rights.

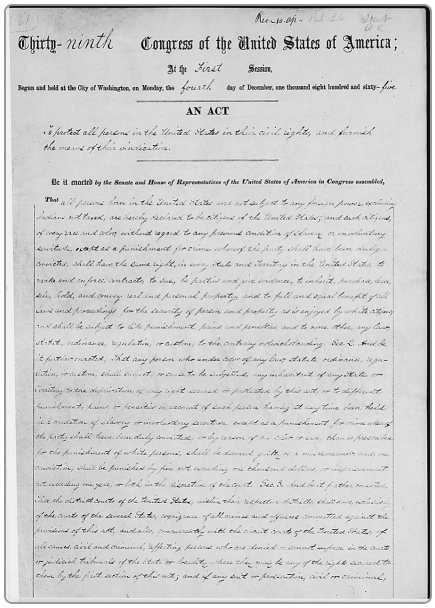
Advertising has a rule all its own: the ban on discriminatory notices, statements and ads applies to **everyone** — exempt owners, brokers, and the newspapers and websites that publish them. HUD's guidance boils down to one sentence: **describe the property, not the people.** "Three bedrooms, fenced yard, one block to the bus" is lawful. "Adults only," "no children," "perfect for a young couple," "Christian home" or "not suitable for wheelchairs" states a preference about people and is not. Words that describe the house — "master bedroom," "family room," "walk-in closet" — are generally fine, and qualified senior housing may say it is senior housing. Brokerages commonly display the **Equal Housing Opportunity** logo or slogan. Look back at your warm-up: list one is the vocabulary of a lawful ad; list two is the vocabulary of a complaint. Fair housing groups and HUD also use **testers** — paired home seekers who differ only in a protected trait — and in *Havens Realty Corp. v. Coleman* (1982) the Supreme Court held that a tester given false information about availability may sue.

The exemptions are few and narrow. (1) The **"Mrs. Murphy" exemption**: rooms or units in a dwelling of **four or fewer** units when the owner lives in one. (2) A **single-family home sold or rented by its owner** who owns no more than three such homes, uses **no broker** and publishes **no discriminatory ad**. (3) **Religious organizations** may prefer their own members in non-commercial housing, unless membership is restricted by race, color or national origin; **private clubs** may limit non-commercial lodging to members. (4) **Housing for older persons** — all residents 62 or older, or 80% of occupied units with a resident 55 or older under published policies. Two rules sit over all four: **no exemption survives the use of a licensee or a discriminatory ad**, and **none excuses racial discrimination**, because the 1866 Act has none. Enforcement: a complaint to **HUD within one year**, followed by investigation, conciliation and, if needed, a charge heard by an administrative law judge or in federal court; a private federal suit within **two years** for damages (including punitive), an injunction and attorney's fees; and **Department of Justice** suits against a pattern or practice. Civil penalties are set by statute and adjusted for inflation — check HUD for current figures.

On the exam today. Expect several fair-housing scenarios. Know the seven classes and their dates, and what is *not* on the federal list — age and marital status (they appear in lending law, Lesson 6.1). The classic traps: "the 1866 Act allows the Mrs.

Murphy exemption" — false, the 1866 Act has no exemptions and covers race; "an owner exempt from the Fair Housing Act may run any ad she likes" — false, the advertising rule binds everyone; "an exempt owner may still use a broker" — false, the exemption is lost the moment a licensee is involved; "steering is legal if the buyer asked for it" — still steering if the agent limits choices by protected class. Match the verbs: urging owners to sell because of who is moving in is **blockbusting**; showing only certain neighborhoods is **steering**; a lender drawing a line around an area is **redlining**. Remember HUD one year, court two years. When a seller tells you not to show the house to a protected class, the answer is always the same: refuse, explain the law, and be prepared to withdraw from the listing.

PICTURE STUDY



Thirty-ninth Congress of the United States of America;

At the First Session,

Begun and held at the City of Washington, on Monday, the fourth day of December, one thousand eight hundred and sixty-five.

AN ACT

To protect all persons in the United States in their civil rights, and furnish the means of their vindication.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

That all persons born in the United States and not subject to any foreign power, excluding Indians not taxed, are hereby declared to be citizens of the United States; and such citizens, of every race and color, without regard to any previous condition of slavery or involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall have the same right, in every State and Territory in the United States, to make and enforce contracts, to sue, be parties, and give evidence, to inherit, purchase, lease, sell, hold, and convey real and personal property, and to full and equal benefit of all laws and proceedings for the security of person and property, as is enjoyed by white citizens, and shall be subject to like punishment, pains and penalties, and to none other, any law, statute, ordinance, regulation, or custom, to the contrary notwithstanding. Sec. 2. And be it further enacted, That any person who, under color of any law, statute, ordinance, regulation, or custom, shall subject, or cause to be subjected, any inhabitant of any State or Territory to the deprivation of any right secured or protected by this act, or to different punishment, pains, or penalties on account of such person having at any time been held in a condition of slavery or involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, or by reason of his color or race, than is prescribed for the punishment of white persons, shall be deemed guilty of a misdemeanor, and on conviction, shall be punished by fine not exceeding one thousand dollars, or imprisonment not exceeding one year, or both, in the discretion of the court. Sec. 3. And be it further enacted, That the district courts of the United States, within their respective districts, shall have, exclusively of the courts of the several States, cognizance of all crimes and offenses committed against the provisions of this act, and also, concurrently with the circuit courts of the United States, of all causes, civil and criminal, affecting persons who are denied or cannot enforce in the courts or tribunals of the State or locality where they may be any of the rights secured to them by the first section of this act; and of all suits and prosecutions, civil or criminal,

The Civil Rights Act of 1866, first page of the enrolled act, Clerk of the Thirty-ninth Congress of the United States (engrossed manuscript), Enacted April 9, 1866 · Ink on paper, printed heading with handwritten text · National Archives and Records Administration, Washington, D.C.

Image: Wikimedia Commons, public domain

This is not a painting but the law itself: the first page of the enrolled bill that became the Civil Rights Act of 1866, written out by a congressional clerk in the year after the Civil War and passed over a presidential veto. Its first section is the sentence that the Supreme Court read, a hundred and two years later in *Jones v. Alfred H. Mayer Co.*, to forbid private racial discrimination in the sale and rental of property. A real estate licensee lives under this page every working day, which is why it opens the unit on the practice of real estate.

Look closely

- Read the handwritten title under “An Act.” Notice the two halves: it protects rights and furnishes “the means of their vindication” — a remedy, not only a promise.
- Find, about halfway down the first section, the list of verbs: to inherit, purchase, lease, sell, hold and convey real and personal property. These are the words a real estate career is made of.
- Look at the hand. Every word was copied by a clerk with a pen; one slip of the pen would be a slip in the law, so the work was slow and careful.

- Notice the ruled margin on the left and the text pressed right to the edge. Space on the page was precious; nothing in the text is decoration.

Talk about it

1. The 1866 Act lists the right to "inherit, purchase, lease, sell, hold, and convey" property. Which of those rights does a real estate licensee help clients exercise on a typical day?
2. Why do you think the 1866 Act, unlike the 1968 Act, was written with no exemptions at all?
3. Leviticus 19:34 commands Israel to treat the stranger "as one born among you." How does honest, equal treatment of every buyer and renter put that command into the ordinary work of a real estate office?

PROJECT

The Fair Housing Desk Reference

Every brokerage keeps a fair housing policy, and every new licensee is expected to know it cold. You will build your own one-page desk reference — the seven classes with their dates, an exemption decision tree, a corrected-advertisement table and the enforcement timeline — and test it against pretend ad copy and pretend requests from pretend clients. It goes into your Pathway File as the first page of the practice section.

You will need

- Your exam notebook and the key terms from this lesson
- One sheet of paper (or a spreadsheet page) for the desk reference
- HUD's Fair Housing Act overview page from this unit's resource list
- Ten index cards

Steps

1. Across the top of the sheet, write the seven federal protected classes in statute order, each with the year it was added. Beneath them, leave a blank line labeled "My state adds:" to fill in from your state's law during Lesson 10.4.
2. Draw the exemption decision tree. Start with "Is race the basis?" (if yes — 1866 Act, no exemption). Then: "Was a licensee used?" and "Was there a discriminatory ad?" (if yes to either — no exemption). Only then branch to the four exemptions with their conditions.
3. On ten index cards, write ten pretend advertising lines — five lawful, five unlawful (for example, "no kids," "ideal for retirees" in a non-senior building, "English speakers preferred"). Shuffle them and sort them using only your desk reference.
4. Rewrite each unlawful line so that it describes the property, not the people, and copy the five corrected lines into a two-column table on the desk reference.
5. Write a three-line script for the day a seller asks you to discriminate: what you say, what you refuse, and what you write down afterward.

6. Add the enforcement timeline as a single arrow: violation → HUD complaint within 1 year → investigation and conciliation → ALJ or federal court; and a second arrow: private federal suit within 2 years.
7. Date the sheet, title it "Fair Housing Desk Reference," and file it.

EXAM NOTEBOOK

1. Make seven flashcards, one per protected class: front — the class; back — the year added and one example of a violation involving it.
2. Draw a three-column table — STEERING, BLOCKBUSTING, REDLINING — with who does it (agent, agent or investor, lender or insurer), what it targets (the buyer's choices, the owners' fears, an area's credit), and a one-line example.
3. Write a trap list titled "No exemption when…" with three lines: a licensee is used; a discriminatory ad is published; the basis is race (1866 Act).

> **From history.** The Civil Rights Act of 1866 was drafted by Senator Lyman Trumbull of Illinois and vetoed by President Andrew Johnson in March 1866. On April 9, 1866, Congress overrode the veto — the first time it had overridden a president to enact a major law. Doubts about Congress's power to pass the Act helped prompt the Fourteenth Amendment, proposed that June, which wrote equal protection of the laws into the Constitution. A century later, the property clause of that 1866 statute became the basis of *Jones v. Alfred H. Mayer Co.*

Example 1. Mrs. Alder owns a fourplex and lives in one unit. She tells a broker, "List the vacant unit, but no families with children — kids are too noisy." May the broker take the listing on those terms?

Show solution

1. Identify the protected class: refusing families with children is familial-status discrimination.
2. Test the Mrs. Murphy exemption: four or fewer units, owner-occupied — Mrs. Alder qualifies when acting on her own.
3. Apply the overriding rule: the exemption is lost when a real estate licensee is used.
4. Conclude: the broker must refuse the discriminatory instruction; taking the listing on those terms would make both broker and owner liable.

Answer: No. Mrs. Alder's exemption covers only her own, unadvertised, broker-free rental. Once a licensee is involved, familial-status discrimination is illegal, and the broker must decline the instruction or the listing.

Example 2. Mr. Birch owns only his own home. He sells it himself, with no broker and no advertising beyond a plain yard sign, and refuses an offer because of the buyer's race. Is the refusal lawful?

Show solution

1. Under the Fair Housing Act, test the single-family exemption: one home owned, no broker, no discriminatory ad — the 1968 Act's exemption appears to apply.
2. Now check the Civil Rights Act of 1866: it protects the right to purchase property free of racial discrimination.
3. The 1866 Act has no exemptions, and *Jones v. Alfred H. Mayer Co.* applies it to private sellers.
4. Conclude: the buyer may sue in federal court under the 1866 Act.

Answer: No. Even where the 1968 Act exempts an owner, the 1866 Act forbids all racial discrimination in property with no exceptions.

Example 3. A buyer couple with three young children asks an agent for homes under a certain price. The agent shows them homes only in one subdivision "full of families" and skips a quiet street of older residents where two matching homes are listed. What has happened, and what should the agent have done?

Show solution

1. Name the protected class: households with children under 18 — familial status.
2. Name the practice: limiting the homes shown because of a protected class is steering, even with friendly motives.
3. Note what the buyers asked for: price and size, not neighborhood makeup.
4. Correct practice: show every listing that meets the buyers' stated objective criteria and let the buyers choose.

Answer: Steering on the basis of familial status. The agent should have shown all homes matching the buyers' price and size criteria, on every street, and let the family decide.

PRACTICE

1. Easy List the seven protected classes of the federal Fair Housing Act.

   Show answer

   Race, color, religion, national origin, sex, familial status and handicap (disability).

2. Easy Which two protected classes were added in 1988, and which one in 1974?

   Show answer

   The Fair Housing Amendments Act of 1988 added handicap and familial status; the Housing and Community Development Act of 1974 added sex.

3. Easy Define blockbusting in one sentence.

   Show answer

   Blockbusting (panic peddling) is inducing owners to sell or rent, for profit, by suggesting that members of a protected class are moving into the neighborhood.

4. **Medium** What did the Supreme Court decide in *Jones v. Alfred H. Mayer Co.* (1968), and why does it matter to an owner who is exempt from the Fair Housing Act?

Show answer

It held that the Civil Rights Act of 1866 bars private racial discrimination in the sale or rental of property. Because the 1866 Act has no exemptions, an owner exempt under the 1968 Act may still never discriminate on the basis of race.

5. **Medium** A landlord tells a caller with a foreign accent that the advertised apartment is rented, then shows it the next day to another caller. Name the violation.

Show answer

Misrepresenting availability because of national origin — falsely stating a dwelling is unavailable is a specific Fair Housing Act violation, and a tester who receives the false statement may sue.

6. **Medium** State the two ways a community may qualify as housing for older persons and so lawfully exclude families with children.

Show answer

Either every resident is 62 or older, or at least 80% of occupied units have at least one resident 55 or older and the community publishes and follows policies showing it is intended for those 55 and over.

7. **Medium** Rewrite this ad line lawfully: “Quiet building, perfect for mature professionals, no kids.”

Show answer

Something like “Quiet building, two bedrooms, laundry on site, near the bus line.” Describe the property, not the people; “mature professionals” and “no kids” state preferences about people and familial status.

8. Hard An owner of a five-unit building lives in one unit and wants to rent only to members of her church. She advertises nothing and uses no broker. Is she exempt?

Show answer

No. The Mrs. Murphy exemption covers only owner-occupied buildings of four or fewer units, and an individual owner is not a religious organization. Refusing renters because of religion here is illegal.

9. Hard A lender makes fewer loans, at higher rates, in one part of town because most residents there share a national origin. What is the practice called, and which law forbids it besides the Fair Housing Act?

Show answer

Redlining. The Fair Housing Act forbids discrimination in residential real estate–related transactions, including lending, and the Equal Credit Opportunity Act also forbids credit discrimination on the basis of national origin.

10. Hard Give the deadlines for a HUD complaint and a private fair housing lawsuit, and name the federal agency that brings pattern-or-practice cases.

Show answer

A HUD complaint within one year of the violation; a private suit in federal court within two years. The Department of Justice brings pattern-or-practice cases.

11. Challenge A homeowner who owns two rental houses wants to rent one through a property manager and asks the manager to “skip applicants with children.” Walk through why no exemption helps her.

Show answer

The single-family exemption requires that no broker or licensed manager be used, so using the manager ends it at once; the Mrs. Murphy exemption does not apply because she does not live in a small multi-unit building she is renting from. The manager must refuse the instruction, since familial status is a protected class.

12. **Challenge** A friendly buyer says, “Just show me neighborhoods where people like us live.” In three sentences, explain how a licensee should respond lawfully and helpfully.

Show answer

> Explain kindly that the law does not let you select neighborhoods by who lives there, but that you will show every home that fits the buyer’s price, size, commute and features. Offer objective tools — maps, school and crime data from public sources, drive-throughs at different times of day — so the buyer can judge for themselves. Then show all homes meeting those criteria and note the conversation in your file.

COMMON MISTAKES

- Thinking the Civil Rights Act of 1866 has the same exemptions as the 1968 Act — it has none, and it covers race.
- Believing an exempt owner may advertise “no children” — the advertising ban applies to everyone, exempt or not.
- Forgetting that every Fair Housing Act exemption is lost when a licensee is used.
- Calling it steering only when the agent is hostile — friendly or “helpful” steering is still steering.
- Mixing up the dates: the first four classes in 1968, sex in 1974, handicap and familial status in 1988.
- Listing age or marital status as federal fair-housing classes — they are not on the federal seven, though lending law and many states cover them.

> **Make it a game · Exempt or Not?.** One player reads a scenario card — “owner-occupied triplex, no broker, wants no children,” “owner of one house, sells by yard sign, refuses a buyer because of race,” “fourplex owner lists with a broker.” Players race to slap the table and call EXEMPT or NOT EXEMPT, then must name the rule that decides it (four units and owner-occupied, no licensee, no ad, the 1866 Act). One point for the call, one for the rule. A wrong EXEMPT on any race card costs two points. Play twelve cards; the winner reads the next lesson’s warm-up aloud.

> **Scripture.** “But the stranger that dwelleth with you shall be unto you as one born among you, and thou shalt love him as thyself; for ye were strangers in the land of Egypt: I am the LORD your God.” (Leviticus 19:34, KJV)
>
> Israel’s law made fair treatment of the newcomer a matter of memory: you know what it is to be a stranger, so do not make others strangers at your door. A licensee who shows every family every home that fits, quotes every renter the same terms and refuses a client’s unlawful request is keeping that old command in a modern form.

9.2 Accessibility, Accommodations and Fair Treatment

OBJECTIVES

- Define handicap (disability) as the Fair Housing Act defines it, including its three prongs and its two narrow exclusions.
- Distinguish a reasonable modification (a physical change, commonly at the resident's expense) from a reasonable accommodation (a change in rules, policies, practices or services), with examples of each.
- Identify which multifamily units must meet the Act's seven design and construction requirements, using the four-unit and March 13, 1991, thresholds.
- Explain what Title III of the Americans with Disabilities Act requires of brokerage offices and other places of public accommodation, and where the ADA does not reach.
- Apply familial-status rules and a reasonable occupancy standard to rental scenarios, and state the licensee's three-step response to a discriminatory request.

> **Warm-up.** Walk (or imagine walking) from the street to your family's kitchen sink in a wheelchair. In five minutes, list every barrier you meet — a step, a narrow door, a high switch, a heavy handle. Star the ones a renter could fix with a small change, and circle the ones that would have been cheap to avoid when the building was designed.

WATCH

Clients With Disabilities No Problem!

Idaho Real Estate Commission · 16:10

https://www.youtube.com/watch?v=D6ZuvccZngM

> **WHEN TO WATCH**
> Watch after core idea four; it is a state commission's own training conversation, so note every practical habit the speakers recommend for serving clients with disabilities and add three to your project log.

BACKUP VIDEO

Fair Housing: Reasonable Accommodation/Modification

CityofHillsboroOR · 6:44

https://www.youtube.com/watch?v=k8XKqFxzNDs

An Oregon city's plain-language explainer; watch it before the practice set and pause after each example to say aloud whether it is a modification or an accommodation.

KEY TERMS

handicap (disability)

Under the Fair Housing Act, a physical or mental impairment that substantially limits one or more major life activities, a record of such an impairment, or being regarded as having one.

reasonable accommodation

A change or exception to a rule, policy, practice or service that a person with a disability needs for an equal opportunity to use and enjoy a dwelling.

reasonable modification

A physical change to a dwelling or common area that a resident with a disability needs for full enjoyment of the premises, made at the resident's expense in private housing.

assistance animal

An animal that works, performs tasks, provides assistance or provides therapeutic emotional support for a person with a disability; under fair housing law it is not a pet.

covered multifamily dwelling

For first occupancy after March 13, 1991: every unit in a building of four or more units with an elevator, and the ground-floor units in a building of four or more units without one.

design and construction requirements

The seven accessibility features the Fair Housing Act requires in covered multifamily dwellings, such as an accessible entrance on an accessible route and usable kitchens and bathrooms.

Americans with Disabilities Act (ADA)

Federal law of 1990 forbidding disability discrimination in employment, public services, and public accommodations and commercial facilities.

Title III (ADA)

The part of the ADA requiring places of public accommodation, such as brokerage and leasing offices, to be accessible and to remove existing barriers where readily achievable.

readily achievable

ADA standard for removing barriers in existing public accommodations: easily accomplishable without much difficulty or expense.

occupancy standard

A limit on the number of people per unit; it must be reasonable and may not be a disguise for excluding families with children.

direct threat

A narrow exception allowing refusal only when an individualized assessment shows a specific person would pose a significant risk to others' health or safety that cannot be reduced by reasonable accommodation.

CORE IDEAS

The story. On September 13, 1988, twenty years after the original law, President Ronald Reagan signed the **Fair Housing Amendments Act of 1988.** It added two protected classes — **handicap** and **familial status** — and it did something no fair-housing law had done before: it told builders how to build. Millions of Americans used wheelchairs, walkers or canes, or lived with impairments of sight, hearing or mind, and the apartments going up across the country were being designed as

though they did not exist — a single step at every entrance, bathroom doors too narrow for a chair, light switches out of reach. Each barrier was cheap to avoid on the drawing board and expensive to remove afterward. The amendments therefore required that multifamily buildings designed and constructed for first occupancy after **March 13, 1991** include basic accessible features, and they gave HUD stronger tools to enforce the whole Act. The law took effect on March 12, 1989, and every apartment complex built since then carries its fingerprints.

How they figured it out. A statute can say "usable," but a builder needs inches. HUD answered with the **Fair Housing Accessibility Guidelines**, published in March 1991, which translated the Act's seven requirements into measurements and drawings — door widths, the clear floor space beside a toilet, the height of an outlet. Meanwhile Congress was writing a broader law. The **Americans with Disabilities Act**, signed on July 26, 1990, reached beyond housing to employment (Title I), state and local government (Title II), and — most important for a brokerage — **public accommodations and commercial facilities (Title III)**, whose duties took effect in January 1992. The two laws divide the ground: the Fair Housing Act governs **dwellings**; the ADA governs places open to the public and commercial buildings. A brokerage office, a model-home sales office or an apartment complex's leasing office is a place of public accommodation under the ADA, while the apartments themselves are dwellings under the Fair Housing Act.

The big idea. The Fair Housing Act protects a person with a **handicap** — today usually called a **disability** — defined in three prongs: a physical or mental impairment that substantially limits one or more major life activities (walking, seeing, hearing, learning, caring for oneself, working); a record of such an impairment; or being regarded as having one. The definition excludes current illegal use of a controlled substance, and a provider may refuse a particular person only if an individualized assessment shows that person would be a **direct threat** to others' health or safety that no reasonable accommodation could reduce — never on stereotypes. Beyond forbidding refusal, the Act imposes two affirmative duties. A **reasonable modification** is a *physical* change — a ramp, grab bars, a wider doorway, a lowered counter. A **reasonable accommodation** is a change in a *rule, policy, practice or service* — allowing an assistance animal in a no-pets building, assigning an accessible parking space, permitting a live-in aide. Memory hook: you *modify* the building; you *accommodate* with the rules.

Who pays, and what can the owner ask? In private housing the resident pays for a **reasonable modification**, and the owner may not refuse permission. The owner may require a description of the work, reasonable assurance it will be done in a workmanlike manner with any required permits, and — for a rental — an agreement to restore the *interior* to its prior condition at move-out where that is reasonable (a lowered kitchen counter might be restored; a widened doorway that harms no one generally would not be). A **reasonable accommodation** generally costs the owner little or nothing and must be granted unless it imposes an undue financial and administrative burden or fundamentally alters the operation. An **assistance animal** is not a pet: no pet deposit or pet rent may be charged for it, though the resident remains liable for any damage it causes. When a disability or the need for an accommodation is not obvious, the owner may ask for reliable information establishing the disability-related need, but may not demand a diagnosis or medical records or ask about the nature or severity of the disability. The owner may never ask an applicant, "Do you have a disability?" as a screening question.

The design and construction rules apply to **covered multifamily dwellings** first occupied after March 13, 1991: **every unit** in a building of **four or more units with an elevator**, and the **ground-floor units** in a building of four or more units without one. Such units must have seven features: (1) an **accessible building entrance on an accessible route**; (2) **accessible public and common-use areas** — mailboxes, laundry, parking, the pool; (3) **usable doors** wide enough for a wheelchair; (4) an **accessible route into and through** the unit; (5) **light switches, outlets, thermostats and other controls** in accessible locations; (6) **reinforced bathroom walls** so grab bars can be added later; and (7) **usable kitchens and bathrooms** with room to maneuver a wheelchair. Builders, architects and developers can all be liable. Under ADA **Title III**, an existing public accommodation — your brokerage office — must remove barriers where **readily achievable**, new construction and alterations must meet the ADA standards, and services must be offered accessibly.

Fair treatment of **familial status** has its own practical rules. A landlord may not advertise or operate "adults only," may not confine families with children to certain floors or buildings, may not charge them higher rent or deposits, and may not impose rules aimed at children that do not apply to adults — unless the property qualifies as housing for older persons (Lesson 9.1). An owner may set an **occupancy standard**, but it must be reasonable; HUD has long treated two persons per bedroom

as a general guideline, adjusted for bedroom size, the ages of the children, the unit's configuration and state and local codes, so a rule that turns away a couple with a newborn from a one-bedroom unit invites a complaint. In lending, the **Equal Credit Opportunity Act** adds its own bases (including marital status, age and public assistance), and redlining violates both laws. Finally, the licensee's duty when a client asks for discrimination — "don't show it to families," "find a reason to turn down the applicant in the wheelchair" — is a three-step habit: **refuse** the instruction, **explain** the law calmly and in writing, and **document** the conversation with your managing broker. If the client insists, withdraw.

On the exam today. The national exam asks disability questions as scenarios. Learn the two-word sort: **modification = physical, resident pays; accommodation = rule change, owner allows**. Traps: "a landlord may charge a pet deposit for a guide dog" — false; assistance animals are not pets. "The landlord must pay for a tenant's grab bars" — false in private housing; the tenant pays, though the landlord must allow them. "A landlord may ask what an applicant's disability is" — false. Know the design thresholds cold: four or more units, first occupancy after **March 13, 1991**; all units with an elevator, ground-floor units without. Know that the **ADA** covers brokerage offices and leasing offices, while the **Fair Housing Act** covers the dwellings — and that a single-family house sold by its owner is not a public accommodation. Expect a familial-status question built on "adults only" or an unreasonable occupancy limit, and a question asking what a licensee should do when a seller wants to discriminate: refuse, explain, document, and withdraw if necessary.

PICTURE STUDY



Tobit and Anna with the Kid, Rembrandt van Rijn, 1626 · Oil on panel · Rijksmuseum, Amsterdam

Image: Wikimedia Commons, public domain

Rembrandt painted this small panel at about twenty years old, in Leiden, from the Book of Tobit: the old man Tobit, blinded, hears a young goat bleating in his house and wrongly accuses his wife Anna of having stolen it. Rembrandt fills the room with the details of an aging household — the cane on the floor, the chair pulled close to the window light, the fire for warmth. It opens this lesson because it shows what the law of accessibility is really about: a home must serve the people who actually live in it, as they are, and the people around them must deal with them truthfully and kindly.

Look closely

- Find the cane lying at the lower left. Tobit's world is arranged around what he can reach and where he can sit.
- Look at where Rembrandt placed his chair — beside the window. Even blind, he sits toward the light and warmth; a home is fitted to its people.
- Study Anna's face and her hands on the goat. She is explaining, not scolding. Notice how much of the painting is about two people misunderstanding each other.
- See how much is packed into a small room — baskets, onions, a spinning wheel, a fire, a dog. Count how many of these things Tobit must navigate by

touch.

Talk about it

1. If Tobit and Anna were renting this room today, name one reasonable modification and one reasonable accommodation that might help them.
2. Tobit misjudges Anna because he cannot see what is in front of him. How can a licensee misjudge a client because of a disability, and how does the law guard against that?
3. Leviticus 19:14 forbids putting "a stumblingblock before the blind." What does it look like for a landlord or an agent to remove stumbling blocks instead of placing them?

PROJECT

The Accessibility Checklist and Request Log

Property managers and brokerages keep a written log of every accommodation and modification request — date received, what was asked, what was decided and why — because a request ignored or delayed is itself a violation. You will build that log for a pretend twelve-unit building and pair it with a seven-point accessibility checklist you test on a real floor plan: your own home or one from a public listing. Both pages go into your Pathway File.

You will need

- A floor plan: your own home sketched to rough scale, or a pretend apartment floor plan you draw
- A tape measure
- One sheet of paper or a spreadsheet for the request log
- Your exam notebook

Steps

1. Write the seven design and construction requirements down the left side of a page, one per row, with three columns: MEETS, DOES NOT MEET, NOTES.
2. Walk your floor plan (or your home) with the tape measure: measure the narrowest doorway, the height of the highest light switch you use daily, and whether there is a step at the entrance. Fill in the checklist honestly; an older single-family home is not covered, so this is practice in seeing, not a verdict.
3. Set up the request log for a pretend twelve-unit building with these columns: DATE RECEIVED, RESIDENT (unit number only), REQUEST, MODIFICATION OR ACCOMMODATION, WHO PAYS, DECISION, DATE ANSWERED, NOTES.
4. Enter five pretend requests: grab bars; an assistance animal in a no-pets building; an accessible parking space near the entrance; a live-in aide; permission to lower a kitchen counter. Classify each and decide it using the lesson's rules.
5. For the one request you might lawfully deny or condition (for example, a restoration agreement for the counter), write a two-sentence explanation in the NOTES column that would satisfy a HUD investigator.

6. Add three practical habits from the video for serving clients with disabilities, and write a one-paragraph office policy: how your pretend brokerage handles a discriminatory request (refuse, explain, document, withdraw).
7. Title the pages “Accessibility Checklist and Request Log,” date them and file them.

EXAM NOTEBOOK

1. Flashcards: front — “modification”; back — “physical change, resident pays, landlord must permit, restoration of interior where reasonable.” Front — “accommodation”; back — “rule or policy change, owner allows unless undue burden; assistance animal is not a pet.”
2. Draw two buildings side by side: one with an elevator (shade every unit) and one without (shade only the ground floor). Label both “4+ units, first occupied after 3/13/1991.”
3. Write a trap list titled “Never ask, never charge”: never ask the nature of a disability; never charge pet fees for an assistance animal; never charge families with children different rent; never run an “adults only” ad outside qualified senior housing.

> **From history.** The ADA’s Title III did not take effect on the day of signing. Congress gave businesses until January 26, 1992, to begin complying, and set the details of “readily achievable” barrier removal and new-construction standards through regulations from the Department of Justice. The first ADA Standards for Accessible Design were published in 1991 and revised in 2010. For a brokerage, that history explains the daily reality: an office in an older building is judged by what is readily achievable, while a newly built or altered office must meet the standards in full.

Example 1. A tenant who uses a wheelchair asks her landlord for permission to install grab bars in the bathroom and a removable ramp at her private entrance. The landlord says, “Only if I don’t pay a cent, and you put it all back when you leave.” Is the landlord within the law?

Show solution

1. Classify the request: grab bars and a ramp are physical changes — reasonable modifications.
2. Who pays: in private housing, the resident pays for a reasonable modification; the landlord may not refuse permission.
3. Restoration: the landlord may require restoration of the interior where reasonable; the grab bars may be removed and patched, and a removable exterior ramp can simply be taken away.
4. Conditions the landlord may set: a description of the work, a licensed or workmanlike installer and any permits.

Answer: Largely yes. The tenant pays, and reasonable restoration may be required. The landlord may not refuse the modifications themselves, and may not charge an extra deposit or rent because of them.

Example 2. A no-pets apartment building receives a request from an applicant with a documented disability to live with an assistance animal. The manager says, “Fine, but there’s a $500 pet deposit and $40 a month pet rent.” Correct the manager.

Show solution

1. Classify: permitting an animal in a no-pets building is a change in policy — a reasonable accommodation.
2. Status of the animal: an assistance animal is not a pet under fair housing law.
3. Fees: no pet deposit or pet rent may be charged for an assistance animal.
4. What remains: the resident is liable for actual damage the animal causes, just as for any other damage beyond normal wear.

Answer: Grant the accommodation and drop the pet deposit and pet rent. The resident remains responsible for any damage the animal actually causes.

Example 3. A developer finished two buildings in 2024: Building A, 24 units on four floors with an elevator; Building B, a 12-unit three-story walk-up with no elevator. Which units must meet the seven design and construction requirements?

Show solution

1. Check the date: both were first occupied after March 13, 1991.
2. Check the size: both have four or more units, so both are covered multifamily dwellings.
3. Building A has an elevator: every unit is covered — all 24.
4. Building B has no elevator: only the ground-floor units are covered — in this example, the 4 units on the first floor.

Answer: All 24 units in Building A and the ground-floor units of Building B (4 units in this example) must have the seven features, from an accessible entrance to usable kitchens and bathrooms.

PRACTICE

1. Easy In one sentence each, define a reasonable modification and a reasonable accommodation.

Show answer

A reasonable modification is a physical change to the premises a person with a disability needs, generally at the resident's expense in private housing; a reasonable accommodation is a change to a rule, policy, practice or service so the person has an equal opportunity to use the home.

2. Easy What date and what building size trigger the Fair Housing Act's design and construction requirements?

Show answer

Multifamily buildings of four or more units designed and built for first occupancy after March 13, 1991.

3. Easy Which title of the Americans with Disabilities Act applies to a real estate brokerage office open to the public?

Show answer

Title III, which covers places of public accommodation and commercial facilities.

4. Medium A landlord asks every applicant, "Do you have any disabilities we should know about?" Is that lawful?

Show answer

No. Asking applicants whether they have a disability, or about its nature or severity, is prohibited; the owner may ask for disability-related information only when a resident requests an accommodation and the need is not obvious.

5. Medium A tenant asks for a reserved parking space close to her door because walking distances is difficult for her. The lot is first-come, first-served. Classify the request and state the likely answer.

Show answer

It is a reasonable accommodation — a change in parking policy — and should generally be granted, since assigning a space costs little and does not fundamentally alter the operation.

6. Medium In a three-story, nine-unit building without an elevator, first occupied in 1998, which units must meet the design requirements?

Show answer

Only the ground-floor units, because the building has four or more units, was first occupied after March 13, 1991, and has no elevator.

7. Medium Name four of the seven design and construction requirements.

Show answer

Any four of: an accessible entrance on an accessible route; accessible public and common-use areas; usable doors; an accessible route into and through the unit; accessible light switches, outlets, thermostats and controls; reinforced bathroom walls for grab bars; usable kitchens and bathrooms.

8. Hard A landlord requires a $300 extra security deposit from a tenant who uses a wheelchair, “for wear on the floors.” Is this permitted?

Show answer

No. Charging a person with a disability a higher deposit because of the disability is a discriminatory term or condition. The landlord may recover actual damage beyond normal wear from the ordinary deposit, as for any tenant.

9. Hard A one-bedroom apartment of generous size is offered to a couple expecting a baby, but the owner says, “Two people maximum, no exceptions.” Analyze the policy.

Show answer

A rigid two-person cap on a one-bedroom unit that turns away a couple with a newborn is likely an unreasonable occupancy standard that discriminates on familial status (a pregnant woman is protected). HUD treats two persons per bedroom only as a general guideline, adjusted for the size of the rooms, the ages of children and local codes.

10. Hard Explain why a model-home sales office must comply with the ADA while the homes in the subdivision are governed by the Fair Housing Act.

Show answer

The sales office is open to the public for business, so it is a place of public accommodation under ADA Title III; the homes are dwellings, which the Fair Housing Act governs. A single property can be subject to both laws in its different parts.

11. Challenge A seller tells his listing agent, "If that buyer in the wheelchair makes an offer, find a reason to reject it." Write the agent's three-part response and what happens if the seller insists.

Show answer

Refuse: the agent will not participate in rejecting a buyer because of disability. Explain: disability is a protected class, the seller and the agent would both be liable, and every offer must be presented and judged on its terms. Document the conversation with the managing broker; if the seller insists, the agent withdraws from the listing.

12. Challenge A tenant asks to widen a bathroom doorway at his own expense. The landlord demands that he narrow it again when he moves out. In three sentences, evaluate the demand.

Show answer

The landlord may require restoration of the interior only where it is reasonable. A widened doorway generally does not interfere with the next tenant's use and may even add value, so requiring it to be narrowed again is likely unreasonable. Restoration demands fit things that would hinder ordinary use, such as a lowered kitchen counter.

COMMON MISTAKES

- Swapping the two duties — a ramp or grab bar is a modification (resident pays), while allowing an assistance animal is an accommodation (a rule change).
- Charging a pet deposit or pet rent for an assistance animal — it is not a pet, though the resident pays for actual damage.
- Applying the design rules to every building — only four-or-more-unit buildings first occupied after March 13, 1991, and only ground-floor units when there is no

elevator.

- Thinking the ADA governs apartments and houses — it governs public accommodations such as brokerage and leasing offices; dwellings are under the Fair Housing Act.
- Asking an applicant to name or describe a disability — only reliable information about a disability-related need, and only when a request is made and the need is not obvious.
- Treating "two per bedroom" as an absolute law — it is a general guideline, adjusted for room size, children's ages and local codes.

Make it a game · Modify or Accommodate?. Write sixteen request slips: ramp, grab bars, assistance animal, reserved parking, live-in aide, lowered counter, wider door, rent due date moved to match a disability check, lever door handles, a sign-language interpreter at the leasing office, and so on. A caller reads each slip; players shout MODIFY or ACCOMMODATE within five seconds for a point, and earn a bonus point for naming who pays. The ADA slips (the leasing office's interpreter, the brokerage's entrance ramp) earn a point only if the player shouts "ADA!" instead. Highest score picks the family's next read-aloud book.

Scripture. "Thou shalt not curse the deaf, nor put a stumblingblock before the blind, but shalt fear thy God: I am the LORD." (Leviticus 19:14, KJV)

The command was given to a people who could have taken advantage of neighbors who could not hear the curse or see the obstacle, and it rests the duty on the fear of God rather than on the chance of being caught. A landlord who allows the grab bars, a builder who widens the door on the drawing board, and an agent who serves every client patiently are removing stumbling blocks instead of placing them.

9.3 Antitrust and Other People's Money

OBJECTIVES

- Explain how the Sherman Antitrust Act of 1890 applies to real estate brokerage, using *United States v. National Association of Real Estate Boards* (1950).
- Identify price fixing, group boycotting, market allocation and tie-in arrangements in brokerage scenarios, and describe the penalty structure for violations.
- Speak about commissions lawfully — as negotiable, set by each firm independently — and describe, as of 2026, how buyer-broker compensation is handled under the MLS rules adopted in August 2024.
- Define trust (escrow) accounts and distinguish commingling from conversion, including the broker's record-keeping and reconciliation duties.
- Describe how a broker handles a disputed earnest-money deposit, including mutual written release, court order and interpleader.

> **Warm-up.** Imagine three bakeries on one street. In five minutes, write what would happen to the price of bread if the three owners met for coffee and agreed on a price — and what would happen if they each set their own. Then write one sentence: who is harmed by the coffee meeting, and who never even knew it happened?

WATCH

Sherman Antitrust Act | Real Estate Exam Prep Video

The Real Estate Classroom · 11:06

https://www.youtube.com/watch?v=o6T1SDiwQgc

> **WHEN TO WATCH**
> Watch after core idea three; write each of the four violations as a heading in your notebook and copy one example under each before you read core idea four.

BACKUP VIDEO

Trust Account Reconciliation

Oregon Real Estate Agency · 8:51

https://www.youtube.com/watch?v=ReqQv8DdAQs

A state agency walks through an actual three-way reconciliation form; watch it during session two with your project spreadsheet open and match each line on the form to a cell in your workbook.

KEY TERMS

Sherman Antitrust Act

Federal law of 1890 forbidding contracts, combinations and conspiracies in restraint of trade, and monopolization; it applies to real estate brokerage.

group boycotting

Two or more competitors agreeing to refuse to deal with, or to cooperate with, another person or firm, such as a discount brokerage.

tie-in arrangement

Conditioning the sale of one product or service on the buyer's purchase of another, such as selling a lot only if the buyer lists or builds with a particular firm.

commingling

Mixing a client's or customer's funds with the broker's own funds, such as depositing earnest money into the brokerage's operating account.

earnest money

A deposit made by a buyer with an offer to show good faith, held in trust and later applied to the purchase price or disbursed as the contract provides.

price fixing

An agreement among competitors to set prices, including commission rates or fees, rather than setting them independently; illegal per se.

market allocation

Competitors agreeing to divide a market — by geography, price range, type of property or customer — so they do not compete with each other.

trust (escrow) account

A separate account at a depository institution, titled as a trust account, in which a broker holds money belonging to others, such as earnest money, rents and security deposits.

conversion

Using money held in trust for the licensee's own purposes — misappropriation, often a crime as well as grounds for license revocation.

interpleader

A court action in which a stakeholder, such as a broker holding disputed earnest money, deposits the funds with the court and asks it to decide who is entitled to them.

reconciliation

The regular comparison of the trust account's bank balance, the broker's trust journal and the total of individual client ledgers to make sure all three agree.

CORE IDEAS

The story. In the 1940s the Washington Real Estate Board, the association of brokers in the nation's capital, published a schedule of "standard" commission rates for selling, renting and managing property. Its code of ethics told members not to charge less, members agreed to abide by the code, and the rates were in fact used in transaction after transaction. Nobody was fined for charging less. The United States sued, and on May 8, 1950, in *United States v. National Association of Real Estate Boards*, the Supreme Court ruled against the board and the national association. Writing for the Court, Justice William O. Douglas held that the business of a real estate broker is "trade" under the Sherman Act, that an agreement among competitors to adopt standard rates is price fixing, and that it made no difference whether the purpose was honorable or whether anyone was punished for departing from the schedule. Every broker in the country has worked under that ruling ever since: **commissions are set by each firm, negotiated with each client, and never agreed among competitors.**

How they figured it out. The **Sherman Antitrust Act**, named for Senator John Sherman of Ohio and signed in 1890, says that every contract, combination or conspiracy in restraint of trade is illegal. Courts soon held that some agreements are so plainly harmful to competition that they are illegal **per se** — no defense of reasonableness is heard — and price fixing among competitors heads that list. The open question for real estate was whether brokers, who sell services rather than goods and often work locally, were in "trade" at all. The 1950 decision answered for brokers; *Goldfarb v. Virginia State Bar* (1975) answered for the learned professions, striking down a county bar's minimum fee schedule for home-purchase title examinations. As of 2026, under MLS rules adopted in August 2024 after a nationwide antitrust settlement, offers of compensation to buyer brokers are not published on the MLS, and a buyer working with an agent signs a written agreement before touring a home. The rule underneath has not changed in seventy-five years:

compensation is negotiable between broker and client, and it is never set by law, by an association or by agreement among competitors.

The big idea. Antitrust law protects competition, and the national exam tests four forms of restraint. **Price fixing** is any agreement among competitors on prices — commission rates, fees, splits offered to cooperating brokers — and the exam treats even a casual conversation as dangerous, because an agreement can be inferred from conduct. **Group boycotting** is two or more competitors agreeing not to deal with someone — refusing to show a discount broker's listings, or agreeing not to cooperate with a new firm. **Market allocation** is competitors dividing the market so they do not compete: "you take everything east of the river, I'll take the west," or by price range, property type or class of customer. A **tie-in arrangement** conditions one sale on the purchase of another product or service — a developer who sells a lot only if the buyer agrees to list the finished house with the developer's brokerage, or to use a particular builder. All four replace independent competition with an arrangement.

The penalties are severe because the harm is quiet. A Sherman Act violation is a federal **felony**: an individual can be fined and imprisoned for up to ten years, and a corporation faces much larger fines. Injured parties may sue for **treble damages** — three times their actual loss — plus attorney's fees, and the government may seek injunctions. State licensing laws add discipline, up to revocation. The safe practice is a set of habits. Never discuss your commission rates or splits with a competitor; if a conversation at an open house or a lunch turns to "what everyone should charge," say plainly that you will not discuss it, leave, and write down what happened. Tell clients the truth: "Our firm's fee is this, and commissions are negotiable." Never say "the standard commission is…" or "everyone charges…," and never suggest that a law or an association sets rates. Set your firm's policies independently, and never agree with other firms to avoid a competitor. A single broker deciding alone not to work with a firm is a business judgment; brokers agreeing together to shut that firm out is a boycott.

The second half of the lesson is **other people's money**. A brokerage regularly holds funds that are not its own: **earnest money** deposits, rents collected for owners, tenants' **security deposits**. These belong in a **trust account** (also called an escrow account) at a depository institution, titled as a trust account, separate from the brokerage's operating account; state law commonly sets how quickly a deposit must be placed there, often within a stated number of banking days after the contract is

accepted. Two violations are tested constantly. **Commingling** is mixing client funds with the broker's own — depositing earnest money into the operating account, or leaving earned commissions sitting in the trust account. (Many states allow a broker to keep a small, stated amount of personal money in the trust account to cover bank charges; check your state.) **Conversion** is spending trust money for the broker's own purposes — paying the office rent with a buyer's deposit, even "just until Friday." Commingling is a serious rule violation; conversion is misappropriation, grounds for revocation and frequently a crime. The **broker**, not the salesperson, is responsible for the trust account, and salespeople turn over funds to the broker promptly.

Trust money demands records. A broker keeps a **journal** of every deposit and disbursement in date order, a separate **ledger** for each client or transaction, and the bank statements — and regularly (commonly monthly) **reconciles** them: the bank balance, adjusted for deposits in transit and outstanding checks, must equal the journal balance, which must equal the sum of all client ledgers. A broker may not make a client's ledger go negative by paying one client's expenses with another's money. Whether a trust account may earn interest, and who receives it, is set by state law and usually requires written agreement. When a deal fails and the buyer and seller **both claim the earnest money**, the broker may not decide the dispute or simply hand the money to the side it represents. The funds stay in trust until there is a **mutual written release** signed by both parties, a **court order**, or — when the broker as stakeholder files one — an **interpleader** action, in which the broker deposits the money with the court and asks the court to decide who is entitled to it. Many states add their own notice procedures.

On the exam today. Antitrust questions are mostly vocabulary in a scenario: two brokers agreeing on a rate is **price fixing**; brokers agreeing not to cooperate with a discount firm is a **group boycott**; dividing a town by territory or price range is **market allocation**; requiring a lot buyer to list with the developer's firm is a **tie-in**. Traps: "price fixing is legal if the rate is reasonable" — false, it is illegal per se; "commission rates are set by the state commission" or "by the local association" — false, they are negotiable between broker and client. Know that penalties include prison, fines and treble damages. On trust funds, know the pair: **commingling = mixing**, **conversion = using**. Know that earnest money is not required for a valid contract (the mutual promises are the consideration), that a bounced earnest-money check must be reported to the seller at once, and that when the parties dispute the

deposit the broker holds it until a mutual release, a court order or interpleader. Finally, the broker — not the salesperson — owns the trust account and answers for it.

PICTURE STUDY



The Moneychanger and His Wife, Marinus van Reymerswaele, 1538 · Oil on oak panel · Museo del Prado, Madrid

Image: Wikimedia Commons, public domain

Marinus van Reymerswaele worked in the Netherlands in the age when Antwerp was becoming the money market of Europe, and he painted this subject — a moneychanger and his wife at their counting table — again and again. Here every detail is about handling money that passes through other people's hands: the delicate balance for weighing coins, the box of standard weights, the account book open beside the cash. It opens this lesson because a brokerage's trust account is the modern version of this table — someone else's money, carefully weighed, carefully written down, and never confused with your own.

Look closely

- Find the small hand balance in the man's fingers. Weighing each coin was how a moneychanger proved honest value; reconciliation is how a broker proves it.
- Look at the open account book under the woman's hand. The record matters as much as the coins — a trust account without a ledger is a trust account in trouble.
- Notice the papers pinned and stacked on the shelf behind them: bills, receipts and notes. Count how many separate records you can see.

- Look at the man's face — absorbed, careful, perhaps a little anxious. What does handling other people's money do to a person's attention?

Talk about it

1. If this couple kept their own household coins in the same pile as their customers' coins, which trust-account violation would that resemble?
2. Why might a painter of 1538 choose to show a woman reading the account book while her husband weighs coins? What does it suggest about checks and balances in handling money?
3. Luke 16:10 says that he who is faithful in that which is least is faithful also in much. Why might a client judge a broker's whole character by how a small earnest-money deposit is handled?

PROJECT

The Trust Account Workbook

You will build a working trust-account workbook for a pretend brokerage — a journal, three client ledgers and a monthly three-way reconciliation — and run a month of pretend transactions through it, including one deliberate mistake you must find. You will finish with a one-page "safe talk" card on commissions and antitrust. Together they become the money-handling pages of your Pathway File.

You will need

- Free spreadsheet software (or ruled paper and a pencil)
- A basic calculator
- Your exam notebook
- The Oregon Real Estate Agency's trust-account reconciliation video (this lesson's backup) for reference

Steps

1. Create a JOURNAL sheet with columns DATE, PAYOR/PAYEE, CLIENT, DEPOSIT, DISBURSEMENT, RUNNING BALANCE. Start at $0.
2. Create three LEDGER sheets — a pretend buyer's earnest money ($10,000), a pretend landlord's rents and a pretend tenant's security deposit ($1,800) — each with the same columns and its own running balance.
3. Enter a month of pretend activity: the $10,000 deposit; four $1,650 rent payments; a $165 management fee paid to the brokerage (moved out of trust, not left in it); a $1,320 repair bill paid for the landlord; and the owner's monthly draw of the remainder.
4. Plant one error on purpose: record the repair bill against the buyer's ledger instead of the landlord's. Then build a RECONCILIATION sheet with a pretend bank statement balance, a deposit in transit and an outstanding check, and show the adjusted bank balance beside the journal balance and the ledger total.
5. Find and correct your planted error, and write two sentences on how a reconciliation reveals a problem even when the bank balance looks fine.

6. Write the “safe talk” card: three sentences you will say about commissions (independent, negotiable, never set by law or association), three sentences you will never say, and what you do if a competitor raises rates at a lunch.
7. Title the pages “Trust Account Workbook and Safe Talk Card,” date them and file them.

EXAM NOTEBOOK

1. Four flashcards for the four antitrust violations, each with a one-line real estate example on the back.
2. Draw a balance scale: on one pan, “bank balance + deposits in transit − outstanding checks”; on the other, “sum of client ledgers.” Label the beam “journal.” Caption: “All three must agree.”
3. Trap list titled “Mixing vs. using”: commingling = mixing funds (earnest money in the operating account); conversion = using funds (paying office rent with a deposit); disputed deposit = hold until mutual release, court order or interpleader.

KEY FORMULAS

$$\text{Adjusted bank balance} = \text{Bank statement balance} + \text{Deposits in transit} - \text{Outstanding checks}$$

$$\text{Adjusted bank balance} = \text{Trust journal balance} = \sum \text{Client ledger balances}$$

From history. Twenty-five years after the real estate boards case, Lewis and Ruth Goldfarb tried to hire a lawyer for the title examination on a house they were buying in Fairfax County, Virginia, and found every lawyer they asked quoted the same fee — one percent of the price, from the county bar’s minimum fee schedule. In *Goldfarb v. Virginia State Bar* (1975) the Supreme Court held that the schedule was price fixing and that the “learned professions” enjoy no exemption from the Sherman Act. The case is still cited whenever any profession tries to set its prices together.

Example 1. At a broker networking lunch, the owner of Firm A says, "Discounting is ruining us. None of us should take a listing for less than 5% — agreed?" Two brokers nod. The owner of Firm C says nothing but keeps eating. Who is at risk, and what should Firm C's owner do?

Show solution

1. Identify the subject: competitors discussing a minimum commission — the core of price fixing.
2. Agreement can be inferred from conduct: nodding and later charging the same rate may be evidence of a conspiracy.
3. Silence is not safe: a competitor who stays at the table and then follows the "agreement" may be treated as a participant.
4. Correct conduct: say plainly that you will not discuss rates, leave the conversation, and write a dated note of what happened for your files.

Answer: Everyone who joined or went along is at risk of a per se Sherman Act violation. Firm C's owner should object openly, leave, and document the departure; every firm must set its fees independently.

Example 2. Brokers Dana and Eli agree that Dana will take only listings above $600,000 and Eli only listings below, "so we stop stepping on each other." Name the violation and explain why it harms the public.

Show solution

1. Identify the arrangement: competitors dividing the market by price range.
2. Name it: market allocation, one of the four restraints the exam tests.
3. The harm: a seller in either range has one fewer competitor bidding for the listing, so service and price competition shrink.
4. Note that geography, property type and customer type are other ways to allocate a market — all illegal when agreed among competitors.

Answer: Market allocation by price range — an illegal agreement among competitors that takes choices away from sellers and buyers.

Example 3. On June 30, a brokerage's trust account bank statement shows $48,500. A $5,000 earnest-money deposit made June 30 is not yet on the statement, and a $2,500 security-deposit refund check has not cleared. The three client ledgers show $30,000, $15,000 and $6,000. Does the account reconcile?

Show solution

1. Adjust the bank balance: $\$48{,}500 + \$5{,}000 - \$2{,}500 = \$51{,}000$.
2. Total the client ledgers: $\$30{,}000 + \$15{,}000 + \$6{,}000 = \$51{,}000$.
3. Compare: the adjusted bank balance equals the sum of the ledgers, so (assuming the journal also shows $51,000) the account reconciles.
4. If the ledgers had totaled more than the adjusted bank balance, money would be missing — a shortage the broker must investigate and correct at once.

Answer: Yes. The adjusted bank balance is $51,000 and the client ledgers total $51,000, so the trust account reconciles.

PRACTICE

1. Easy What year was the Sherman Antitrust Act passed, and what does it forbid?

   Show answer

   1890. It forbids contracts, combinations and conspiracies in restraint of trade, and monopolization — including price fixing among real estate brokers.

2. Easy Define commingling and conversion in one sentence each.

   Show answer

   Commingling is mixing clients' funds with the broker's own funds; conversion is using clients' funds for the broker's own purposes.

3. Easy Who sets a real estate commission?

   Show answer

   The broker and the client, by negotiation. Commissions are never set by law, by a commission or by an association, and competitors may not agree on them.

4. Medium Several brokers agree not to show the listings of a new flat-fee brokerage. Name the violation.

Show answer

Group boycotting — competitors agreeing together to refuse to deal with another firm.

5. Medium A developer sells lots only to buyers who agree to list their finished homes with the developer's brokerage. Name the violation.

Show answer

A tie-in arrangement — conditioning the sale of one product (the lot) on the purchase of another service (the listing).

6. Medium What did the Supreme Court decide in *United States v. National Association of Real Estate Boards* (1950)?

Show answer

That real estate brokerage is "trade" under the Sherman Act and that a board's adoption of standard commission rates its members were expected to follow was illegal price fixing, even without penalties for charging less.

7. Medium A salesperson receives a $5,000 earnest-money check at an open house on Saturday. What should she do with it?

Show answer

Turn it over promptly to her broker (or deposit it as the broker's procedures direct) so it is placed in the broker's trust account within the time state law requires; she must never deposit it in a personal or operating account.

8. Hard A broker pays the office's electric bill from the trust account, intending to repay it when a commission closes next week. Which violation is this, and how serious is it?

Show answer

Conversion — using trust money for the broker's own purposes, whatever the intent to repay. It is grounds for license revocation and may be prosecuted as theft or embezzlement.

9. Hard A sale falls through. The buyer demands his $12,000 earnest money back; the seller demands it as liquidated damages. What may the broker do?

Show answer

Hold the funds in trust and release them only on a mutual written release signed by both parties, a court order, or the court's decision in an interpleader action the broker files; the broker may not decide the dispute or pay either side on its own judgment. State law may add notice procedures.

10. Hard A trust bank statement shows $32,400, with a $2,000 deposit in transit and a $900 outstanding check. Client ledgers total $34,000. Reconcile and state what the result means.

Show answer

Adjusted bank balance $= \$32{,}400 + \$2{,}000 - \$900 = \$33{,}500$. The ledgers total $34,000, so the account is $500 short — clients' money is missing or a record is wrong, and the broker must find and correct it immediately.

11. Challenge A seller asks, "What's the standard commission around here?" Write a lawful two-sentence answer and explain what makes the common reply unlawful-sounding.

Show answer

"Our firm's fee for this service is ___, and commissions are fully negotiable between you and the broker you hire; other firms set their own fees." Saying "the standard commission is…" suggests a rate fixed by custom or agreement among competitors, the very idea antitrust law forbids.

12. Challenge Explain why one broker who decides alone never to cooperate with a certain firm is treated differently from three brokers who agree to do the same.

Show answer

The Sherman Act forbids agreements in restraint of trade; a single firm's independent business decision is not an agreement among competitors. When three firms agree together to shut a competitor out, the combination itself is the violation — a group boycott — because it replaces independent competition with a joint plan.

COMMON MISTAKES

- Believing price fixing is legal if the agreed rate is fair or customary — it is illegal per se, whatever the rate or motive.
- Saying commission rates are set by the state, the commission or the local association — they are negotiated between each broker and client.
- Confusing commingling (mixing funds) with conversion (using funds for oneself).
- Letting the broker decide who gets disputed earnest money — the funds stay in trust until a mutual release, a court order or interpleader.
- Leaving an earned commission or management fee in the trust account — once earned, it must be withdrawn, or it becomes commingling.
- Thinking a salesperson owns the trust account — the broker is responsible for it and for every deposit.

Make it a game · Name That Restraint. Write twenty scenario slips: ten antitrust (two brokers agree on 5%; three firms refuse to show a discount firm's listings; "you take the east side"; a lot sold only if the buyer lists with the developer) and ten trust-money (earnest money in the operating account; office rent paid from trust; a bounced deposit check; a disputed deposit). A caller reads each slip; the first player to name it — price fixing, boycott, allocation, tie-in, commingling, conversion, report it, or interpleader — scores a point. Naming the remedy or the right conduct earns a bonus point. Ten minutes on the clock; the winner chooses the family's Saturday breakfast.

Scripture. "He that is faithful in that which is least is faithful also in much: and he that is unjust in the least is unjust also in much." (Luke 16:10, KJV)

Jesus spoke these words in a parable about a steward entrusted with another man's goods — the exact position of a broker holding earnest money and rents. The habits of a trust account (separate funds, exact ledgers, monthly reconciliation) are small faithfulnesses, and clients rightly read a broker's whole character in them.

9.4 Running a Lawful Brokerage

OBJECTIVES

- Describe the supervising broker's responsibilities and explain vicarious liability for the acts of licensees and staff.
- State the three IRS requirements for a real estate agent to be a statutory nonemployee and compare independent-contractor and employee status.
- Sort tasks that unlicensed assistants may and may not perform, and explain the line between filling in approved forms and the unauthorized practice of law.
- Apply the National Do Not Call Registry, Telephone Consumer Protection Act and CAN-SPAM rules to prospecting by phone, text and email.
- Explain lawful advertising and social-media practice, data security and wire-fraud prevention, and the role of errors-and-omissions insurance in risk management.

> **Warm-up.** List every way a real estate agent might reach a stranger who could become a client — phone, text, email, mailers, social media, door knocking, a yard sign. In five minutes, put a star by the ones you think are regulated by federal law. You will check your stars against core idea five.

WATCH

Agent-Broker Relationship | Real Estate Exam Prep Videos

The Real Estate Classroom · 10:19

https://www.youtube.com/watch?v=PFp-RJoBfeg

> **WHEN TO WATCH**
> Watch after core idea three; copy his employee-versus-independent-contractor whiteboard table into your notebook and add the three IRS requirements beneath it.

BACKUP VIDEO

Do Not Call Registry | Real Estate Exam Prep Videos

The Real Estate Classroom · 10:46

https://www.youtube.com/watch?v=MXqclvCxuU0

Watch before writing page 4 of your compliance binder, and pause to check each rule he states against the rules listed in core idea two.

supervising (managing, designated) broker

The licensed broker responsible under state law for supervising the licensees and activities of a brokerage; states use different titles for the role.

independent contractor

A worker paid for results who controls the methods of the work; the payer does not withhold income or Social Security taxes.

unlicensed assistant

A person who performs clerical and administrative tasks for a licensee but may not perform activities that require a license, such as negotiating or showing property in most states.

National Do Not Call Registry

The federal list, opened in 2003, of telephone numbers that telemarketers may not call to solicit sales absent an exception, such as an established business relationship or written permission.

vicarious liability

Legal responsibility of a principal, such as a broker, for the wrongful acts of agents or employees committed within the scope of their work (respondeat superior).

statutory nonemployee (qualified real estate agent)

Under federal tax law, a licensed real estate agent paid substantially all for sales output rather than hours, under a written contract stating the agent will not be treated as an employee for federal tax purposes.

unauthorized practice of law

Giving legal advice or drafting legal documents without a law license; a real estate licensee may fill in approved forms but must refer legal questions to an attorney.

Telephone Consumer Protection Act (TCPA)

Federal law of 1991 restricting telemarketing calls, autodialed and prerecorded calls, texts and fax advertising; enforced by the FCC and through private lawsuits.

CAN-SPAM Act

Federal law of 2003 setting rules for commercial email: truthful headers and subject lines, identification as an advertisement, a valid postal address and a working opt-out honored promptly.

errors and omissions (E&O) insurance

Professional liability insurance covering claims of negligent mistakes or omissions in professional services; it does not cover fraud or intentional wrongdoing.

blind ad

An advertisement by a licensee that fails to identify the brokerage (or, for a licensee selling his own property, that he is licensed); generally prohibited.

wire fraud (business email compromise)

A scheme in which criminals impersonate a title company, closing agent or licensee by email to trick a buyer into wiring closing funds to a fraudulent account.

CORE IDEAS

The story. At midnight on June 27, 2003, the Federal Trade Commission opened a website, and by the afternoon of the first day more than six hundred thousand Americans had typed in their home telephone numbers. Within the first few days the count passed ten million; by the end of September it was nearly fifty-two million. The site was the **National Do Not Call Registry**, and starting on October 1, 2003, telemarketers who called a registered number to sell something faced federal penalties. Few industries felt the change more sharply than real estate, where a generation of agents had built their businesses on the cold call — the evening phone call to a homeowner whose listing had just expired, or to a family selling by owner. The registry did not forbid prospecting; it changed how a lawful brokerage prospects. This lesson is about that working day: who is responsible for whom, who may do what, and how a firm finds business lawfully.

How they figured it out. Congress had begun with the **Telephone Consumer Protection Act of 1991**, which limited calling hours, restricted autodialed and prerecorded calls, banned most unsolicited fax advertising, and required each company to keep its own do-not-call list. Company-by-company lists proved too weak, so in 2003 the FTC amended its Telemarketing Sales Rule to create a national registry and the FCC adopted matching rules; email got the **CAN-SPAM Act of 2003.** A firm that telemarkets must check the registry at least every **31 days**, keep and honor

its own **company-specific** do-not-call list, call only between **8 a.m. and 9 p.m.** the called person's local time, and transmit caller ID. Two common exceptions allow calls to registered numbers: an **established business relationship** (commonly up to 18 months after a transaction or 3 months after the consumer's inquiry) and the consumer's **written permission**. Autodialed or prerecorded telemarketing calls and texts to cell phones require prior express written consent.

The big idea. A brokerage is a **supervised** business. Every salesperson (or entry-level broker, as Washington and Oregon call the license) works under a **supervising broker** — the managing, principal or designated broker, depending on the state — who is responsible for supervising the licensees, reviewing contracts, maintaining the trust account, approving advertising and keeping records. Listings and buyer agreements are contracts with the **brokerage**, not with the individual agent. Because agents act for the broker, the broker can be held **vicariously liable** for their wrongful acts within the scope of their work, and a state commission can discipline the broker for failing to supervise. For tax purposes, most agents are **independent contractors**. Federal tax law treats a **qualified real estate agent** as a **statutory nonemployee** if three conditions are met: the agent is **licensed**; substantially all of the agent's pay is tied to **sales or output, not hours worked**; and a **written contract** states that the agent will not be treated as an employee for federal tax purposes. Then the broker withholds no income or Social Security tax, and the agent pays self-employment tax.

Independent-contractor status changes what the broker may control. The broker must still supervise for legal compliance — state license law, fair housing, trust funds, advertising — because the license law requires it. But a broker who treats contractors like employees (setting their hours, requiring attendance as a condition of pay, providing employee benefits) risks the contractor status the written agreement claims. **Employees** — commonly a receptionist, a transaction coordinator or an unlicensed assistant — are paid for their time, with taxes withheld. **Teams** are groups of licensees working together within one brokerage; they advertise under the brokerage's name, and a team name may not suggest that the team is a separate firm. **Unlicensed assistants**, in the common pattern, may answer phones, schedule appointments, assemble files, enter listing data, order reports, prepare advertising for a licensee's approval and deliver documents; they may **not** show property, discuss or negotiate price or terms, interpret contracts, give opinions of value,

host an open house alone or solicit clients — the activities that require a license. States vary.

A licensee is not a lawyer. Filling in the blanks of a **standard form** approved for licensees (by the state, the commission or attorneys for that purpose) is permitted; drafting contract language from scratch, telling clients how they should hold title, predicting the tax effect of a sale, or advising whether to sue is the **unauthorized practice of law** — or of tax advice, or of appraisal (Lesson 4.2). The right sentence is, "That is a legal question; you should ask an attorney," written in an email so there is a record. **Advertising** carries its own rules: every ad must identify the brokerage as licensed (a **blind ad** without it is prohibited), a licensee advertising his own property must disclose that he is licensed, claims must be truthful and not misleading, and fair housing and lending-advertising rules (Lessons 9.1 and 6.1) apply. Social media promotion is advertising. Prospecting follows core idea two: calling a by-owner seller or an expired listing to **solicit a listing** is a telemarketing call subject to the registry, while calling that same seller because your buyer wants to see the house is not a solicitation of your services. Commercial email needs truthful headers and subject lines, an ad label, a postal address and a working opt-out.

A modern brokerage also guards **confidential information.** Clients hand over bank statements, Social Security numbers, loan files and their reasons for selling; a careful office secures such records and shares them only as needed. The sharpest danger is **wire fraud**: criminals break into email accounts, watch a transaction, and send the buyer convincing "updated wiring instructions" days before closing. The defense is a habit: warn every buyer in writing at the start that wiring instructions will never change by email, and require that any instructions be confirmed by a phone call to a number the buyer already knows to be the closing agent's — never a number in the suspicious email. If money is misdirected, call the bank at once. Finally, **risk management** means insurance and diligence. **Errors and omissions** insurance covers claims of negligent professional mistakes — a misstated lot size, a missed deadline — but not fraud or intentional wrongdoing; some states require it. **General liability** covers the visitor who slips at the office or an open house. Diligence covers the rest: verify facts, use checklists, document conversations and keep records as your state requires.

On the exam today. The three IRS requirements for statutory nonemployee status — **licensed, paid for output, written contract** — are a favorite; the trap is "paid an

hourly wage," which defeats the status. Know that listings belong to the **broker**, that the broker is responsible for supervision and the trust account, and that vicarious liability reaches acts within the scope of the agent's work. Know the Do Not Call basics: registry checked every **31 days**, calls between **8 a.m. and 9 p.m.**, exceptions for an established business relationship and written permission, and the rule that soliciting a by-owner seller's listing is telemarketing. Know that an unlicensed assistant may not show property or negotiate, and that filling in an approved form is permitted while drafting legal language or giving legal advice is not. E&O insurance does not cover intentional acts. And when a buyer receives an email changing wiring instructions, the correct answer is always to **verify by phone with a known number** before sending a dollar.

PICTURE STUDY



A Cotton Office in New Orleans, Edgar Degas, 1873 · Oil on canvas · Musée des Beaux-Arts, Pau, France

Image: Wikimedia Commons, public domain

Edgar Degas visited his mother's family in New Orleans in 1872–73 and painted their cotton-brokerage office — his uncle in the foreground testing a sample, his two brothers among the men behind. It was the first of his paintings bought by a museum. It opens this lesson because it is a portrait of a brokerage at work: a firm of independent-minded men sharing one office, a senior partner checking quality, a clerk keeping the books, buyers and sellers coming and going. Change cotton to houses and the questions are the same — who supervises, who keeps the records, and who answers for what everyone else does.

Look closely

- Find the old man in the foreground with the cotton in his fingers. He is checking the product himself — the supervising partner's eye on quality.
- Look at the clerk at the right bent over a ledger. Every brokerage runs on records; ask who in a real estate office would hold that pen.
- Notice the man in the middle reading a newspaper with his legs crossed. Not everyone in the office is busy at the same moment — a reminder that contractors set their own pace.
- Follow the long room back to the open door and windows. Business comes in from the street; the office must be open, honest and orderly to everyone who

walks through.

Talk about it

1. Which figure in this office would be responsible if a clerk made a costly mistake in the books — and what is that responsibility called today?
2. Degas painted members of his own family. How might family loyalties make supervision harder in a small brokerage, and how should a broker guard against that?
3. Proverbs 22:1 says a good name is rather to be chosen than great riches. How does a brokerage build or lose its good name through the conduct of its least experienced agent?

PROJECT

The Brokerage Compliance Binder

Every well-run brokerage keeps a policy manual. You will write a short one for a pretend firm — the supervision chart, the contractor agreement checklist, the assistant's task list, the prospecting rules and the wire-fraud warning letter. It is the longest single document in your Pathway File and the one a hiring broker would most like to see you understand.

You will need

- Five sheets of paper or a word-processing document
- Your exam notebook and the lesson's key terms
- The IRS independent-contractor page from this unit's resource list
- A pretend brokerage name of your own invention

Steps

1. Page 1, the supervision chart: draw the pretend firm with one supervising broker, four licensees (two on a team), one unlicensed assistant and a part-time bookkeeper. Beside each person, write who supervises them and what records they touch.
2. Page 2, the contractor checklist: list the three statutory-nonemployee requirements and five things the broker will and will not control for contractors, with one sentence of reason for each.
3. Page 3, the assistant's task list: two columns, MAY and MAY NOT, with at least eight entries in each, and a note that your state may draw lines differently.
4. Page 4, the prospecting rules: registry check every 31 days, calling hours, the company do-not-call list, the two exceptions, the cell-phone and text rule, the by-owner rule and the four CAN-SPAM requirements — each in one sentence.
5. Page 5, the wire-fraud warning letter: write a one-paragraph letter your pretend firm hands every buyer at the first meeting, telling them how wiring instructions will (and will never) be delivered and what to do if they receive a change.

6. Add a closing paragraph naming the two insurance policies the firm carries (E&O and general liability) and what each does and does not cover.
7. Title the binder with your pretend firm's name, date it and file it.

EXAM NOTEBOOK

1. Flashcard: front — "statutory nonemployee"; back — "licensed + paid for output, not hours + written contract."
2. Draw a clock face shaded from 8 a.m. to 9 p.m. and label it "legal telemarketing hours (called party's time)." Beside it, write "registry check: every 31 days" and the two exceptions.
3. Trap list titled "Not the agent's job": drafting contract clauses; advising how to hold title; predicting taxes; telling an unlicensed assistant to show the house; changing wiring instructions by email.

> **From history.** For decades the IRS and real estate brokers argued case by case over whether commissioned agents were employees, with back taxes and penalties at stake. Congress settled the question in the Tax Equity and Fiscal Responsibility Act of 1982, adding a section to the tax code that treats licensed real estate agents and direct sellers as nonemployees when they are paid for output under a written contract. The rule has stood, nearly unchanged, ever since, and it is the reason most agents receive an information return instead of a paycheck.

Example 1. Northgate Realty pays its agent Mara only commissions on closed sales, she is licensed, and she signed a written agreement saying she will not be treated as an employee for federal tax purposes. The broker now wants to require Mara to work 9 to 5 in the office every weekday. Analyze her status and the broker's plan.

Show solution

1. Test the three requirements: licensed — yes; paid substantially all for output, not hours — yes; written contract stating nonemployee status — yes.
2. Conclude: Mara is a statutory nonemployee for federal tax purposes; the broker does not withhold income or Social Security tax.
3. Weigh the plan: a contractor controls her own methods; requiring set hours treats her like an employee and undercuts the contractor relationship the agreement describes.
4. Distinguish what the broker must still do: supervise her for compliance with license law, fair housing, advertising and trust-fund rules.

Answer: Mara qualifies as a statutory nonemployee. The broker must supervise her for legal compliance but should not control her working hours like an employer's; that is the line between contractor and employee.

Example 2. Agent Theo finds a for-sale-by-owner sign and looks up the owner's number, which is on the National Do Not Call Registry. May he call (a) to ask for the listing, and (b) because his buyer client wants to see the house?

Show solution

1. Classify call (a): asking the owner to hire Theo is a solicitation of services — a telemarketing call.
2. Apply the registry: no established business relationship and no written permission, so (a) is prohibited.
3. Classify call (b): calling on behalf of a buyer who wants to purchase the home is not soliciting the owner to buy Theo's services.
4. Note the safe practice: if Theo mentions listing services during call (b), it becomes a solicitation; keep it to the buyer's interest.

Answer: (a) No — soliciting the listing is telemarketing to a registered number with no exception. (b) Yes — a call about a buyer's interest in purchasing is not a solicitation, so long as Theo does not pitch his listing services.

Example 3. Sort these tasks for an unlicensed assistant: scheduling a showing; telling a caller the seller "would probably take less"; preparing a draft ad for the agent to approve; hosting an open house alone; ordering a title report; explaining the financing contingency to a buyer.

Show solution

1. Clerical and administrative tasks are generally permitted: scheduling a showing, preparing a draft ad for approval, ordering a title report.
2. Discussing price or what the seller will accept is negotiation — a licensed activity — and here also a breach of the seller's confidentiality.
3. Hosting an open house alone involves showing property and answering buyers' questions — commonly licensed activity.
4. Explaining a contract contingency is interpreting a contract — licensed activity at least, and close to legal advice.

Answer: Permitted: scheduling, drafting the ad for approval, ordering the title report. Not permitted: discussing price, hosting the open house alone, explaining the contingency. States draw the exact lines; check yours.

PRACTICE

1. Easy Who owns a listing agreement — the individual agent or the brokerage?

   Show answer

   The brokerage. The listing is a contract between the seller and the broker; the agent works on the broker's behalf.

2. Easy State the three IRS requirements for a real estate agent to be a statutory nonemployee.

   Show answer

   The agent is licensed; substantially all pay is based on sales or output rather than hours worked; and a written contract states the agent will not be treated as an employee for federal tax purposes.

3. **Easy** During what hours may a telemarketing call be placed?

Show answer

Between 8 a.m. and 9 p.m., measured by the local time of the person being called.

4. **Medium** How often must a firm that telemarkets check the National Do Not Call Registry, and name the two common exceptions that allow calls to registered numbers.

Show answer

At least every 31 days. Exceptions: an established business relationship (commonly 18 months after a transaction or 3 months after an inquiry) and the consumer's written permission.

5. **Medium** What is vicarious liability, and why does it matter to a supervising broker?

Show answer

It is a principal's legal responsibility for the wrongful acts of agents or employees within the scope of their work. A broker can be sued for an agent's misrepresentation or negligence and disciplined for failing to supervise.

6. **Medium** A seller asks his agent whether he should hold title with his new wife as joint tenants or tenants in common. How should the agent answer?

Show answer

Explain that how to hold title is a legal question with tax and estate consequences and recommend that the seller consult an attorney; giving that advice would be the unauthorized practice of law.

7. **Medium** Name four requirements of the CAN-SPAM Act for commercial email.

Show answer

Truthful header information; a non-deceptive subject line; identification of the message as an advertisement; a valid physical postal address; and a clear way to opt out that is honored promptly. Any four.

8. Hard A licensee posts on social media: “Gorgeous 3-bedroom just reduced — message me!” with no brokerage name. What is wrong?

Show answer

It is a blind ad: advertising by a licensee must identify the brokerage as licensed (states set the exact requirement). Social media promotion of a listing is advertising and is subject to the same rules, including fair housing.

9. Hard An agent’s E&O carrier refuses to pay a claim arising from the agent’s deliberate concealment of a known roof leak. Why?

Show answer

Errors and omissions insurance covers negligent mistakes and omissions in professional services, not fraud or intentional wrongdoing. Deliberately concealing a known material defect is intentional misrepresentation.

10. Hard A broker pays an unlicensed assistant an hourly wage and directs her schedule. Is the assistant an independent contractor or an employee, and what follows for taxes?

Show answer

An employee: she is paid for time and her work is controlled by the broker, and she cannot be a statutory nonemployee because she is not licensed. The broker withholds income and Social Security taxes and pays the employer’s share.

11. Challenge Three days before closing, a buyer receives an email that looks like it comes from the title company with “updated wiring instructions.” Write the four steps the buyer’s agent should insist on.

Show answer

Do not wire or reply to the email; call the title company at a phone number already known from earlier documents or its official website; confirm the instructions verbally before any wire; and if money has already been sent, call the bank immediately to try to recall it and report the fraud.

12. **Challenge** In three sentences, explain why a supervising broker who never reviews her agents' contracts or ads is both a legal risk and a poor steward.

Show answer

State law makes the broker responsible for supervising licensees, so unreviewed work exposes her to discipline and vicarious liability for every agent's mistake. The public trusts the brokerage name, not just the individual agent, and unreviewed work betrays that trust. Supervision is how a broker protects clients, the agents she is training and the firm's good name all at once.

COMMON MISTAKES

- Thinking an hourly wage is compatible with statutory nonemployee status — the agent must be paid for output, not hours, under a written contract.
- Believing the agent owns the listing — the listing belongs to the brokerage.
- Assuming calls to by-owner sellers are exempt from Do Not Call — soliciting their listing is telemarketing.
- Letting an unlicensed assistant show property, discuss price or explain contract terms — those require a license.
- Treating E&O insurance as a shield for intentional acts — it covers negligence, not fraud.
- Answering a legal question about title, taxes or a lawsuit — refer the client to an attorney or tax professional.

> **Make it a game · Licensed or Not?.** Make twenty task cards: answer the phone, show the house, order a title report, quote a price the seller will take, place a sign, host an open house, draft a clause, fill in a standard form, cold-call a by-owner seller at 9:30 p.m., send an email with no opt-out. One player draws and reads; the others hold up a green card (anyone may), a yellow card (licensee only) or a red card (nobody may — it breaks a law). One point for each correct card, two if the player names the rule. Ten minutes; the loser sets the table.

> **Scripture.** “A good name is rather to be chosen than great riches, and loving favour rather than silver and gold.” (Proverbs 22:1, KJV)
>
> A brokerage’s good name is built by its least experienced agent on her worst day as much as by its founder on his best, which is why supervision, honest advertising and careful records matter so much. Solomon’s proverb sets the order of priorities a lawful office lives by: the name first, the commission second.

9.5 Property Management

OBJECTIVES

- Describe the management agreement — the agency it creates, its essential terms and how the manager is paid.
- Explain the property manager's duties: marketing and leasing, fair and uniform tenant screening, rent collection, security deposits, maintenance and reporting.
- Distinguish preventive, corrective, routine and construction maintenance, and operating, capital and stabilized budgets.
- Apply the four risk-management strategies (avoid, control, transfer, retain) and name the insurance coverages a managed property commonly carries.
- Calculate a management fee, a vacancy rate and a simple annual operating budget with net operating income.

> **Warm-up.** Think of a building you know well — your church, a school, an apartment complex, your own home. In five minutes, list everything someone must do every week, every month and every year to keep it working and paid for. Circle the jobs that cost money even when nothing is broken.

WATCH

National Real Estate Exam Prep: Property Management & Leasing

Best Real Estate Career · 4:32

https://www.youtube.com/watch?v=IktpEAtVaB0

> **WHEN TO WATCH**
> Watch after core idea seven as a quick self-test: pause before each answer is revealed, say your answer and your reason aloud, then check it.

BACKUP VIDEO

Property Maintenance | Real Estate Prep Exam Video

The Real Estate Classroom · 8:17

https://www.youtube.com/watch?v=J-jGkh9BzAk

Watch after core idea four to review the kinds of maintenance; for each kind he names, add one task to your project's maintenance calendar.

property manager

A person or firm hired by an owner to market, lease, operate and maintain a property and to protect the owner's investment; commonly a general agent of the owner.

management agreement

The written contract between owner and manager establishing the agency and stating the manager's authority, duties, term, compensation, reporting and the handling of funds.

management fee

The manager's compensation, most commonly a percentage of rents actually collected, sometimes with leasing, renewal or project fees.

vacancy rate

The share of units (or of potential rent) not occupied or not earning rent over a period; occupancy rate is its complement.

preventive maintenance

Scheduled work done to keep equipment and structures from failing, such as servicing furnaces and cleaning gutters.

corrective maintenance

Repairs made after something breaks, such as fixing a leaking pipe or replacing a broken window.

construction maintenance

New construction, renovation or tenant improvements (build-outs) that change or add to the property, often for a particular tenant.

operating budget

The annual projection of a property's income and expenses used to manage day-to-day operations.

capital reserve budget

A plan and fund for major replacements and improvements, such as a roof, boilers or parking lot, set aside over time.

stabilized budget

A forecast of income and expenses over several years under normal, stabilized occupancy and operating conditions.

risk management (ACTS)

Handling risk by avoiding it, controlling it, transferring it (usually by insurance) or retaining it.

resident manager

A manager who lives on the property and handles day-to-day operations, often as an employee of the owner or management firm.

CORE IDEAS

The story. In 1865 a young London woman named Octavia Hill persuaded the art critic John Ruskin to buy the leases on three run-down houses in Paradise Place, in the Marylebone district, and to let her manage them. The tenants were poor, the buildings were filthy and the rents were collected irregularly or not at all. Hill made a bargain with both sides. To Ruskin she promised a steady return on his money — about five percent — to prove that decent housing for working families could pay its way. To the tenants she promised prompt repairs, clean stairways and fair dealing, and she asked in return for rent paid in full every week. She collected it herself, door to door, which meant she saw every family and every broken step. The houses improved, the rent came in, and other owners began asking her to manage their buildings. By the end of the century Octavia Hill had trained a generation of managers and set down the method every property manager still uses: know the property, know the people, keep the books, and serve the owner and the residents at the same time.

How they figured it out. Hill's insight was that management is a profession, not a side job: someone must stand between an owner who wants a return and residents who want a decent home, and must be trusted by both. Modern law formalized her role as **agency**. The **management agreement** makes the manager the owner's agent — usually a **general agent**, because the manager handles a continuing range of tasks (leasing, collecting, hiring repair contractors, paying bills) rather than one transaction. A sound agreement names the parties and describes the property; states the term and how it may be terminated; spells out the manager's authority (for example, repairs up to a stated dollar amount without the owner's approval) and the owner's responsibilities; sets the budget and reporting schedule; directs how funds are handled in trust; requires the insurance each side carries; commits both to fair housing law; and states the **compensation**. The most common fee is a **percentage of rents actually collected** — which ties the manager's pay to the owner's real income —

sometimes with separate leasing, renewal or construction-supervision fees. Like commissions, management fees are negotiable.

The big idea. A property manager's job is to produce the greatest **net operating income** the property can sustainably earn while **preserving its value** for the owner — not the highest rent this month at the cost of the building next year. Rent is set by **market analysis**: a survey of comparable units, adjusted for size, condition, amenities and location, just as an appraiser adjusts comparables (Lesson 4.3). Vacancy is the manager's gauge. A **vacancy rate** well above the local market's suggests rents are too high, the property is poorly maintained or marketed, or screening is too slow; a vacancy rate far below the market, with a waiting list, suggests rents may be below market. **Marketing and leasing** must follow fair housing law (Lessons 9.1 and 9.2): ads describe the property, and every applicant is measured by the same **written screening criteria** — income relative to rent, credit and rental history, verified references — applied uniformly and documented. Inconsistent screening is the most common way a well-meaning manager ends up in a fair housing complaint.

Once residents are in, the manager collects rent, enforces the lease and keeps the property in repair. Rent is collected on a firm, written schedule with late fees stated in the lease and allowed by state law. **Security deposits** are held in trust as state law requires, with written move-in and move-out condition reports, and returned (with any lawful deductions itemized) within the state's deadline. Lease violations are handled in writing and, if necessary, through the lawful court eviction process — never by changing locks or shutting off utilities. Federal law adds one rule worth knowing by name: the **Servicemembers Civil Relief Act** allows a servicemember to end a residential lease early upon entering active duty, receiving permanent-change-of-station orders or deploying for 90 days or more, and limits evictions of servicemembers and their families without a court order. **Maintenance** comes in four kinds the exam names: **preventive** (scheduled work that prevents failure — servicing the furnace, cleaning gutters), **corrective** (repairs after something breaks), **routine** (the recurring housekeeping of common areas and grounds), and **construction** (renovations, additions and **tenant improvements** or build-outs, common in commercial space).

Managers plan with three budgets. The **operating budget** projects one year of income and expenses: potential gross income, less vacancy and collection loss, gives

effective gross income; less operating expenses (taxes, insurance, utilities, repairs, management, reserves) gives net operating income. **Debt service** — the owner's mortgage payment — is the owner's financing cost, not an operating expense of the property, and depreciation is a tax concept, not a cash expense; neither belongs in operating expenses. The **capital reserve budget** plans for big replacements — roof, boilers, parking lot, appliances — by setting money aside each year, commonly expressed per unit. The **stabilized budget** projects income and expenses over several years at normal occupancy, smoothing out a single unusual year, and is the one investors use to judge value. Every month the manager sends the owner an **operating report**: rents collected, vacancies, expenses paid, funds held in trust, and the work done — the accounting duty of an agent (Lesson 8.2) in its most practical form.

Every property carries risks, and managers sort them with four strategies remembered as **ACTS: avoid** the risk (remove the diving board), **control** it (install railings, better lighting and smoke detectors; train staff), **transfer** it (buy insurance or shift it by contract), or **retain** it (accept small, predictable losses, often through deductibles). The usual coverages for a managed property are **property insurance** for the buildings (often a package policy; flood and earthquake are separate), **general liability** for injuries to visitors and residents in common areas, **loss-of-rents** (rent-loss or business-income) coverage that replaces rent while a damaged building is repaired, **workers' compensation** for employees, and **fidelity bonds** protecting against employees who handle money. Large buildings often employ a **resident manager**, who lives on site and handles day-to-day leasing, collections and maintenance; many states exempt resident managers of a single owner's property from licensing, while a management firm that leases and collects rents for others generally must be licensed — check your state.

On the exam today. Property management is a small share of the national exam, but its questions are predictable. Know that the management agreement creates a **general agency** and that the most common fee is a **percentage of rents collected** (not of potential rent). Know the four maintenance types and match them: servicing the boiler is **preventive**; fixing a burst pipe is **corrective**; building out a tenant's office is **construction**. Know the three budgets — operating, capital reserve, stabilized. Know the ACTS strategies, and that buying insurance is **transferring** risk. Know that **debt service and depreciation are not operating expenses**, a trap that reappears in the

income approach. Watch for these traps too: high vacancy suggests rents too high, not too low; screening criteria must be written and applied uniformly; a manager must never use self-help eviction. Expect one calculation — a management fee on collected rent, a vacancy rate, or a budget line.

PICTURE STUDY



The Dakota apartment house, Central Park West, New York, Unknown photographer (Historic American Buildings Survey copy), About 1890 · Photograph · Library of Congress, Prints and Photographs Division, Washington, D.C.

Image: Wikimedia Commons, public domain

The Dakota, designed by the architect Henry J. Hardenbergh and opened in 1884, was one of the first large luxury apartment houses in New York, built when the land around it on Central Park West was still mostly empty. This photograph, preserved by the Historic American Buildings Survey, shows it standing nearly alone above a dirt avenue. It opens this lesson because a building like this needs management from the first day: dozens of households under one roof, a staff, boilers and elevators, rents to collect and an owner who expects a return — exactly the work of a property manager.

Look closely

- Count the chimneys and dormers. Each one is a roof penetration that must be flashed, inspected and maintained — preventive maintenance on a grand scale.
- Look at how empty the street is. The owner was betting on future demand; a manager had to fill the building before the neighborhood filled in.
- Find the small wooden house and fence at the left. Compare the two buildings: one family on one lot, many families in one managed building.

- Notice the telegraph poles and the unpaved avenue. Utilities and streets were arriving at the same time as the tenants.

Talk about it

1. If you managed this building in 1890, which of the four kinds of maintenance would take most of your time, and why?
2. The Dakota was built before the neighborhood around it. How would you set rents when there are almost no comparable buildings nearby?
3. Proverbs 27:23 tells a herdsman to know the state of his flocks. What would it look like for a manager to know the state of a building and of the families living in it?

PROJECT

The Property Management Plan

You will prepare a management plan for a pretend 24-unit apartment building — the kind of document a management firm presents to win an owner's business. It includes a management-agreement term sheet, a rent survey, a one-year operating budget, a maintenance calendar and a risk matrix. It is the capstone of Unit 9 in your Pathway File and pulls together agency, trust money, fair housing and the arithmetic of income property.

You will need

- Free spreadsheet software
- A basic calculator
- Three to five rental listings from a public website for apartments near you (rent, bedrooms and features only — no names or addresses of residents)
- Your exam notebook

Steps

1. Term sheet: in one page, list the parties (pretend owner, your pretend firm), the property, the term, the manager's authority (including a repair limit without approval), the fee (as a percentage of rents collected plus any leasing fee), reporting, trust-account handling, insurance and a fair housing commitment.
2. Rent survey: record three to five comparable apartments from public listings, adjust each for size and features in a simple grid, and choose a monthly rent for the pretend building's two-bedroom units, with one sentence of reasoning.
3. Operating budget: in the spreadsheet, build potential gross income, vacancy and collection loss (choose a rate and explain it), effective gross income, six operating expense lines including the management fee and reserves, and NOI. Add a note showing that debt service is excluded.
4. Maintenance calendar: list twelve tasks across the year and label each preventive, corrective, routine or construction.

5. Risk matrix: name eight risks (a slip on icy steps, a kitchen fire, an employee who mishandles rent, a vacancy-heavy winter, and so on) and assign each an ACTS strategy and, where it applies, an insurance coverage.
6. Screening criteria: write the five written, uniform criteria every applicant will be measured by, and one sentence on how you will document each decision.
7. Title the plan "Property Management Plan — [pretend building name]," date it and file it.

EXAM NOTEBOOK

1. Flashcards for the four maintenance types, each with a one-line example: preventive (service the boiler), corrective (fix the burst pipe), routine (mow and clean the halls), construction (tenant build-out).
2. Draw the budget staircase: PGI → minus vacancy and collection loss → EGI → minus operating expenses → NOI, with a side door labeled "debt service and depreciation do NOT enter here."
3. Trap list titled "Property management traps": fee on rents collected, not potential; insurance = transfer; high vacancy = rents too high; never self-help eviction; screening must be written and uniform.

KEY FORMULAS

$$\text{Management fee} = \text{Rents collected} \times \text{Fee rate}$$

$$\text{Vacancy rate} = \frac{\text{Vacant units (or lost rent)}}{\text{Total units (or potential rent)}}, \quad \text{Occupancy rate} = 1 - \text{Vacancy rate}$$

$$\text{EGI} = \text{PGI} - \text{Vacancy and collection loss}$$

$$\text{NOI} = \text{EGI} - \text{Operating expenses} \quad \text{(not debt service, not depreciation)}$$

From history. Octavia Hill's work with housing led her to care about open land as well. In 1895, with the lawyer Sir Robert Hunter and the clergyman Hardwicke Rawnsley, she founded the National Trust, which buys and protects historic houses, farms, coastline and countryside in England, Wales and Northern Ireland. Today it is one of the largest private landowners in Britain. The same woman who collected weekly rents on Paradise Place helped create an institution whose whole business is the long-term stewardship of property.

WORKED EXAMPLES

Example 1. A 24-unit building rents each unit for $1,400 a month. In March, 2 units sit vacant all month and every occupied unit pays in full. The management fee is 8% of rents collected. What is March's fee?

Show solution

1. Rents collected come only from occupied units: $24 - 2 = 22$ units.
2. Collected rent: $22 \times \$1{,}400 = \$30{,}800$.
3. Fee: $\$30{,}800 \times 0.08 = \$2{,}464$.
4. Note the trap: 8% of potential rent ($24 \times \$1{,}400 = \$33{,}600$) would be $2,688 — wrong, because the fee is on rents collected.

Answer: $2,464 — 8% of the $30,800 actually collected.

Example 2. A 40-unit complex has averaged 1 vacant unit all year. Comparable buildings nearby average 6% vacancy, and the complex has a waiting list. What is its vacancy rate, and what does it suggest?

Show solution

1. Vacancy rate: $\frac{1}{40} = 0.025 = 2.5\%$.
2. Occupancy rate: $1 - 0.025 = 0.975 = 97.5\%$.
3. Compare: 2.5% is well below the 6% market average, and there is a waiting list.
4. Interpret: rents may be below market; the manager should run a market survey of comparable units before the next renewals.

Answer: Vacancy is 2.5% (occupancy 97.5%). Far below the market with a waiting list, it suggests rents may be set below market, so a rent survey is in order.

Example 3. Build a one-year operating budget for the 24-unit building in example 1 (in this example): rent $1,400 per unit per month; vacancy and collection loss 5%; property taxes $38,000; insurance $12,500; utilities $21,600; repairs and maintenance $30,000; management fee 8% of effective gross income; replacement reserves $300 per unit. The owner's mortgage payments are $150,000 a year. Find NOI.

Show solution

1. Potential gross income: $24 \times \$1{,}400 \times 12 = \$403{,}200$.
2. Vacancy and collection loss: $\$403{,}200 \times 0.05 = \$20{,}160$; EGI $= \$403{,}200 - \$20{,}160 = \$383{,}040$.
3. Management fee: $\$383{,}040 \times 0.08 = \$30{,}643.20$; reserves: $24 \times \$300 = \$7{,}200$.
4. Operating expenses: $\$38{,}000 + \$12{,}500 + \$21{,}600 + \$30{,}000 + \$30{,}643.20 + \$7{,}200 = \$139{,}943.20$.
5. NOI: $\$383{,}040 - \$139{,}943.20 = \$243{,}096.80$. The $150,000 of mortgage payments is debt service — excluded.

Answer: NOI is $243,096.80. Mortgage payments are not an operating expense; the owner pays them out of NOI.

PRACTICE

1. Easy What kind of agent is a property manager usually, and why?

   Show answer

   A general agent, because the manager handles a continuing range of tasks for the owner — leasing, collecting rent, contracting for repairs — rather than a single transaction.

2. Easy Name the four strategies of risk management.

   Show answer

   Avoid, control, transfer (usually by insurance) and retain — ACTS.

3. Easy Which type of maintenance is replacing furnace filters on a schedule?

   Show answer

   Preventive maintenance — scheduled work that keeps equipment from failing.

4. Medium A manager earns 6% of rents collected. A building's potential rent is $52,000 for the month, but $4,500 was lost to vacancy and $1,500 to unpaid rent. What is the fee?

Show answer

Collected rent $= \$52{,}000 - \$4{,}500 - \$1{,}500 = \$46{,}000$; fee $= \$46{,}000 \times 0.06 = \$2{,}760$.

5. Medium A 60-unit complex has 9 units vacant. What are the vacancy and occupancy rates?

Show answer

Vacancy $= 9 \div 60 = 0.15 = 15\%$; occupancy $= 85\%$.

6. Medium Name the three kinds of budget a property manager prepares and the purpose of each.

Show answer

The operating budget projects one year of income and expenses; the capital reserve budget plans and funds major replacements; the stabilized budget forecasts several years under normal occupancy and conditions.

7. Medium An owner buys a rent-loss insurance policy. Which ACTS strategy is that, and what does the coverage do?

Show answer

Transfer. Rent-loss (loss-of-rents) coverage replaces rental income while a building damaged by a covered peril is being repaired.

8. Hard A manager's building has 14% vacancy while comparable buildings average 5%. Give three possible causes and the first step the manager should take.

Show answer

Rents may be above market, the property may be poorly maintained or marketed, or screening and turnover may be too slow. The first step is a market survey of comparable units, followed by an inspection of the vacant units and a review of advertising and leasing procedures.

9. Hard In a year, a property has PGI of $310,000, vacancy and collection loss of 7%, operating expenses of $118,300 and mortgage payments of $96,000. Find EGI and NOI.

Show answer

Vacancy loss $= \$310{,}000 \times 0.07 = \$21{,}700$; EGI $= \$288{,}300$; NOI $= \$288{,}300 - \$118{,}300 = \$170{,}000$. The $96,000 of mortgage payments is debt service and is not subtracted to find NOI.

10. Hard A manager approves one applicant with a 600 credit score but rejects another with the same score "because she seemed difficult." What is the risk, and what practice prevents it?

Show answer

Inconsistent screening invites a fair housing complaint if the rejected applicant belongs to a protected class, because the stated reason is subjective. Written screening criteria applied uniformly to every applicant, with each decision documented, prevent it.

11. Challenge An owner wants to raise NOI by skipping preventive maintenance for two years. Write three sentences explaining the short-term and long-term effects to the owner.

Show answer

Skipping preventive maintenance lowers expenses and raises NOI for a year or two. But deferred maintenance causes larger corrective repairs, higher vacancy as the property declines, and a lower stabilized NOI that investors use to set value. The manager's duty is to maximize sustainable income while preserving value, so the honest advice is to keep the preventive schedule.

12. Challenge A 36-unit building rents at $1,250 a month per unit with 4% expected vacancy. The manager's fee is 7% of collected rent. Estimate the annual management fee.

Show answer

PGI $= 36 \times \$1{,}250 \times 12 = \$540{,}000$; collected (in this example, vacancy only) $= \$540{,}000 \times 0.96 = \$518{,}400$; fee $= \$518{,}400 \times 0.07 = \$36{,}288$.

COMMON MISTAKES

- Computing the management fee on potential rent instead of rents actually collected.
- Subtracting mortgage payments (debt service) or depreciation as operating expenses.
- Reading high vacancy as a sign that rents are too low — it usually means rents are too high or the property is poorly run.
- Calling the purchase of insurance "retaining" risk — insurance transfers risk; deductibles retain it.
- Mixing up maintenance types — corrective is after a breakdown, preventive is before, construction changes or adds to the property.
- Using self-help eviction (lockouts, utility shutoffs) instead of the court process.

Make it a game · Manager's Dice Budget. Each player starts with a 12-unit pretend building renting at $1,000 a unit. Roll one die for vacant units this month, then a second die for a surprise: 1 burst pipe ($800, corrective), 2 furnace service ($200, preventive), 3 new tenant build-out ($1,500, construction), 4 insurance premium ($600), 5 snow removal ($300, routine), 6 quiet month. Each player computes collected rent, an 8% management fee and the month's NOI on paper, naming the maintenance type aloud. Correct math earns a point; the highest NOI after five rounds earns two more. Ten minutes, calculators allowed.

Scripture. "Be thou diligent to know the state of thy flocks, and look well to thy herds." (Proverbs 27:23, KJV)

Solomon's advice to the herdsman is the property manager's job description: know the condition of what is entrusted to you, inspect it, and act before small problems grow. A manager who walks the halls, reads the reports and knows the families in the building is being diligent in exactly this sense.

UNIT 9

The Practice of Real Estate

On April 11, 1968, a law was signed that changed the working day of every real estate office in America, and it still governs yours. This unit is about that working day — the rules that apply not to one contract or one property but to everything a licensee does. You will begin with the **Fair Housing Act** and the far older **Civil Rights Act of 1866**: the seven federal protected classes, the narrow exemptions, and the practices the law forbids by name — **steering**, **blockbusting**, **redlining** and discriminatory advertising. You will learn what the law requires for residents with disabilities — the difference between a **reasonable modification** and a **reasonable accommodation**, the design rules for apartments built since 1991, and the **Americans with Disabilities Act** in your own office.

Then you will turn to money and management. The **Sherman Antitrust Act** explains why commissions are always negotiable and never agreed among competitors, and the law of **trust accounts** explains why a buyer's earnest money must never touch the broker's own bank account. You will see how a brokerage is supervised, why most agents are **independent contractors**, what an unlicensed assistant may do, how the Do Not Call Registry and email law shape prospecting, and how to stop a wire-fraud scheme before a family loses its down payment. The unit ends with **property management** — the management agreement, budgets, maintenance and risk — and the arithmetic of a building that must pay its way.

PREREQUISITES

- Can define agent, principal, client and customer, and list the fiduciary duties, from Unit 8
- Can explain earnest money and its role in a purchase agreement, from Lesson 7.3
- Can compute effective gross income and net operating income, from Lesson 4.5
- Has the exam notebook current, with the Unit 8 trap lists ready for review

MASTERY CHECKLIST

- ☐ I can name the seven federal protected classes with their dates and explain how the Civil Rights Act of 1866 and *Jones v. Alfred H. Mayer Co.* add a rule with no exemptions.
- ☐ I can identify steering, blockbusting, redlining, misrepresenting availability and discriminatory advertising in a scenario, and apply the four Fair Housing Act exemptions correctly.
- ☐ I can tell a reasonable modification from a reasonable accommodation, say who pays, and state which multifamily units must meet the design and construction requirements.
- ☐ I can recognize price fixing, group boycotting, market allocation and tie-in arrangements, and explain why commissions are always negotiable.
- ☐ I can distinguish commingling from conversion, reconcile a trust account, and describe how a

broker handles disputed earnest money.

- ☐ I can state the three requirements for statutory nonemployee status and sort tasks an unlicensed assistant may and may not perform.
- ☐ I can apply the Do Not Call, TCPA and CAN-SPAM rules to prospecting and explain how to prevent wire fraud at closing.
- ☐ I can describe the management agreement, the maintenance types, the three budgets and ACTS, and compute a management fee, a vacancy rate and NOI.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **HUD: Fair Housing Act Overview**: Free, official. The Department of Housing and Urban Development's plain-language summary of what the Act covers, the protected classes, the exemptions and how to file a complaint. Use it with Lessons 9.1 and 9.2 and for the extension on your desk reference. Ages 15 and up.
- **U.S. Department of Justice: The Fair Housing Act**: Free, official. The Civil Rights Division's page on the Act it enforces through pattern-or-practice suits, with a clear section on disability and the design and construction requirements. Read it with Lesson 9.2. Ages 15 and up.
- **ADA.gov: Title III — Businesses and Nonprofits**: Free, official. The Justice Department's guide to the ADA's public-accommodation rules, including barrier removal in existing buildings. Use it during Lesson 9.2 to see what a brokerage office must do. Ages 15 and up.
- **U.S. DOJ Antitrust Division: Price Fixing, Bid Rigging, and Market Allocation Schemes**: Free, official. The Antitrust Division's primer on the agreements it prosecutes and how to recognize them. Read it with Lesson 9.3 before writing your safe-talk card. Ages 15 and up.
- **IRS: Independent Contractor (Self-Employed) or Employee?**: Free, official. The IRS's page on worker classification, with links to the rules for statutory nonemployees. Use it with Lesson 9.4's compliance binder. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

9.1	**Fair Housing: The Law and Its History**	3 sessions of 50 minutes
9.2	**Accessibility, Accommodations and Fair Treatment**	3 sessions of 50 minutes
9.3	**Antitrust and Other People's Money**	3 sessions of 50 minutes
9.4	**Running a Lawful Brokerage**	3 sessions of 50 minutes
9.5	**Property Management**	3 sessions of 50 minutes

Unit 9 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Seventy percent — 14 of 20 — matches the common passing line, but aim higher. Figures marked “in this example” are examples; real deadlines, fees and penalties are checked with HUD, the FTC or your state commission. Choose the one BEST answer.

1. **5 pts**

   Which of the following is NOT one of the seven protected classes under the federal Fair Housing Act?

   A. Familial status

   B. Marital status

   C. National origin

   D. Handicap

2. **5 pts**

   The Civil Rights Act of 1866, as applied in *Jones v. Alfred H. Mayer Co.*, prohibits discrimination in the sale or rental of property based on:

   A. Religion

   B. Sex

   C. Familial status

   D. Race

3. **5 pts**

   A licensee goes door to door telling owners that families of a certain national origin are moving onto the street and that they should list now before values fall. This is:

   A. Blockbusting

   B. Steering

   C. Redlining

   D. A tie-in arrangement

4. 5 pts

The “Mrs. Murphy” exemption from the Fair Housing Act applies to:

A. Any single-family home sold by its owner

B. Any building of six units or fewer

C. Rooms or units in an owner-occupied dwelling of four or fewer units, with no broker and no discriminatory advertising

D. Any rental housing owned by a religious organization

5. 5 pts

A renter believes she was refused an apartment because she is pregnant. Within what period must she file a complaint with HUD?

A. 180 days

B. One year

C. Two years

D. Three years

6. 5 pts

A tenant who uses a wheelchair asks to install grab bars in the bathroom of his privately owned apartment. Who generally pays for the grab bars?

A. The tenant

B. The landlord

C. HUD

D. The landlord and tenant equally

7. 5 pts

Which building must have accessible ground-floor units under the Fair Housing Act’s design and construction requirements?

A. A triplex first occupied in 2010

B. A 20-unit building first occupied in 1985

C. A single-family home built in 2020

D. An 8-unit walk-up without an elevator first occupied in 2005

8. 5 pts

A resident with a disability-related need asks to keep an assistance animal in a no-pets building. The landlord may:

A. Charge the usual pet deposit and pet rent

B. Refuse, because the no-pets policy applies to everyone

C. Grant the request without pet fees, while holding the resident liable for any actual damage

D. Require the resident to provide a full medical diagnosis

9. 5 pts

Title III of the Americans with Disabilities Act applies most directly to:

A. A real estate brokerage office open to the public

B. A single-family home sold by its owner

C. The bedrooms of an owner-occupied duplex

D. A private vacation cabin

10. 5 pts

Two brokers agree that one will take listings only north of the highway and the other only south of it. This is:

A. Price fixing

B. Market allocation

C. Group boycotting

D. A tie-in arrangement

11. 5 pts

A real estate commission rate is determined by:

A. The state real estate commission

B. The local real estate association

C. Federal law

D. Negotiation between the broker and the client

12. 5 pts

A broker deposits a buyer's earnest-money check into the brokerage's operating account to save a trip to the bank. This is:

A. Conversion

B. Interpleader

C. Commingling

D. Novation

13. 5 pts

A transaction fails, and the buyer and seller each demand the $8,000 earnest money held by the listing broker. The broker should:

A. Hold the funds in trust until a mutual written release, a court order or an interpleader decision

B. Return the money to the buyer, who paid it

C. Pay the money to the seller, the broker's client

D. Split the money equally between them

14. 5 pts

A trust account statement shows $20,000. There is a $3,000 deposit in transit and $1,200 in outstanding checks. The adjusted bank balance that should equal the total of the client ledgers is:

A. $24,200

B. $21,800

C. $18,200

D. $20,000

15. 5 pts

Which fact would DEFEAT a real estate agent's treatment as a statutory nonemployee for federal tax purposes?

A. The agent holds a real estate license

B. The agent signed a written contract stating she is not an employee

C. The agent is paid an hourly wage

D. The agent is paid only commissions on closed sales

16. 5 pts

Under federal telemarketing rules, a licensee prospecting by phone may call:

A. Between 7 a.m. and 10 p.m. the caller’s time

B. Only between 9 a.m. and 5 p.m.

C. Between 8 a.m. and 8 p.m. the caller’s time

D. Between 8 a.m. and 9 p.m. the called person’s local time

17. 5 pts

An unlicensed assistant working for a broker may generally:

A. Schedule showing appointments

B. Show a listed home to buyers

C. Discuss the price the seller might accept

D. Explain the terms of the purchase agreement

18. 5 pts

Two days before closing, a buyer receives an email that appears to be from the title company with new wiring instructions. The buyer’s agent should advise the buyer to:

A. Wire the funds immediately to avoid delaying closing

B. Reply to the email to confirm the new instructions

C. Call the title company at a known, verified number before sending any funds

D. Forward the email to the lender and then wire the funds

19. 5 pts

A manager earns 7% of rents collected. A 30-unit building rents for $1,200 per unit, and 3 units were vacant all month; all other rent was paid. The monthly fee is:

A. $2,520

B. $2,268

C. $2,160

D. $25,200

20. 5 pts

A property manager has the boilers inspected and serviced every fall before the heating season. This is:

A. Corrective maintenance

B. Construction maintenance

C. Routine maintenance

D. Preventive maintenance

ANSWER KEY

1. B. The federal seven are race, color, religion, national origin, sex, familial status and handicap. Marital status appears in the Equal Credit Opportunity Act and in many state laws, but not on the federal fair-housing list.
2. D. The 1866 Act protects the right of all citizens to buy and rent property on the same terms as white citizens — race, with no exemptions. The other classes come from the 1968 Act and its amendments.
3. A. Inducing owners to sell for profit by suggesting a protected class is moving in is blockbusting, or panic peddling. Steering limits a buyer's choices; redlining is done by lenders and insurers.
4. C. The owner must live in a building of four or fewer units, and the exemption is lost if a broker or a discriminatory ad is used. A describes a different, narrower exemption.
5. B. A HUD complaint must be filed within one year of the violation; a private lawsuit may be filed within two years. Pregnancy is protected under familial status.
6. A. A reasonable modification — a physical change — is made at the resident's expense in private housing, and the landlord may not refuse it. B confuses a modification with an accommodation.
7. D. The rules cover buildings of four or more units first occupied after March 13, 1991; without an elevator, the ground-floor units are covered. A is too small, B too old and C is not multifamily.
8. C. Allowing the animal is a reasonable accommodation; an assistance animal is not a pet, so no pet fees, but the resident remains responsible for damage. Demanding a diagnosis is not allowed.
9. A. Title III covers places of public accommodation and commercial facilities, such as brokerage and leasing offices. Dwellings are governed by the Fair Housing Act instead.
10. B. Competitors dividing a market by territory is market allocation, illegal under the Sherman Act. Price fixing concerns agreed prices; a boycott is a joint refusal to deal.
11. D. Commissions are always negotiable and are never set by law or by any association; competitors agreeing on rates is price fixing.
12. C. Mixing client funds with the broker's own funds is commingling. Conversion would be using the money for the broker's own purposes.

13. A. The broker is a stakeholder and may not decide the dispute; the funds stay in trust until both parties agree in writing or a court decides, often through interpleader. C favors the client but violates the broker's duty as holder of trust funds.
14. B. $\$20{,}000 + \$3{,}000 - \$1{,}200 = \$21{,}800$. A adds the outstanding checks instead of subtracting them.
15. C. Statutory nonemployee status requires a license, pay based on output rather than hours, and a written contract. An hourly wage is pay for time, not output.
16. D. Telemarketing calls are limited to 8 a.m. to 9 p.m., measured at the location of the person called, and numbers on the Do Not Call Registry may not be called without an exception.
17. A. Clerical tasks such as scheduling are permitted. Showing property, discussing price and explaining contract terms are activities that require a license.
18. C. Changed wiring instructions by email are the signature of wire fraud; they must be verified by phone with a number already known to belong to the closing agent. Replying to the email (B) reaches the criminal.
19. B. Collected rent is $27 \times \$1{,}200 = \$32{,}400$, and $\$32{,}400 \times 0.07 = \$2{,}268$. A computes the fee on potential rent, which the manager did not collect.
20. D. Scheduled work that keeps equipment from failing is preventive maintenance. Corrective maintenance happens after a breakdown; construction maintenance changes or adds to the property.

PORTFOLIO PIECE: MY PATHWAY FILE — THE PRACTICE PAGES

Assemble the practice section of your Pathway File: the Fair Housing Desk Reference with its seven classes and dates, exemption decision tree and corrected advertising table (9.1); the Accessibility Checklist tested on a real floor plan and the Request Log for a pretend twelve-unit building (9.2); the Trust Account Workbook with its journal, three client ledgers, three-way reconciliation and the planted error you found, together with your Safe Talk Card on commissions (9.3); the five-page Brokerage Compliance Binder for your pretend firm, from supervision chart to wire-fraud warning letter (9.4); and the Property Management Plan for a pretend 24-unit building, with term sheet, rent survey, operating budget, maintenance calendar and risk matrix (9.5).

Close the section with a one-page letter to a pretend new agent joining your pretend firm. In your own words, explain the three promises every licensee makes to the public — to treat every person fairly, to handle other people's money as a trust, and to stay within the law and one's competence — and connect them to Leviticus 19:34 and Luke 16:10. Date every page.

LOOK FOR	WHAT IT MEANS
Fair Housing Desk Reference	All seven federal classes appear in statute order with correct dates; the decision tree places the 1866 Act, the licensee rule and the advertising rule before the four exemptions; every corrected ad line describes the property, not the people.
Accessibility pages	The seven design requirements are listed and honestly applied to a real floor plan; each of the five logged requests is correctly classified as a modification or accommodation with the right payer and a defensible decision.
Trust Account Workbook	Journal, ledgers and reconciliation agree to the penny after the planted error is found and corrected; earned fees leave the trust account; the Safe Talk Card never implies a standard or agreed commission.
Brokerage Compliance Binder	The supervision chart, contractor checklist, assistant task list and prospecting rules are accurate and complete, and the wire-fraud letter tells a buyer exactly how to verify instructions.
Property Management	The rent survey is reasoned from comparables; the operating budget computes EGI and NOI correctly with debt service

LOOK FOR	WHAT IT MEANS
Plan	excluded; every maintenance task and risk is labeled with the right type and ACTS strategy.
Letter to a new agent	Written in the student's own voice, it states the three promises clearly and ties them to the two Scripture passages without canned language.

UNIT 10

The Math, the State Exam and the Road to the License

Twenty-four centuries ago, Egyptian surveyors re-measured flooded fields so that each owner paid tax only on the land the river had left him. Their three questions — how big, what fraction, how much money — are still the questions of every math item on a real estate exam, and this unit gathers them into one toolkit. You will master the **T-bar** of part, whole and rate; area, acreage and volume; the money math of **commissions**, **net listings**, **points**, **loan-to-value**, **mills** and **prorations**, ending with a closing statement that balances to the penny; and the investor's math of **cap rates**, **cash-on-cash return**, **depreciation**, **adjusted basis** and the two great tax rules every licensee must know by number, **Section 121** and **Section 1031**.

Then you will look past the national exam to the **state portion**: what every state tests, what Washington, Oregon, Idaho, Montana and Alaska require according to their own licensing agencies, and how to build a dated facts sheet for any state from official sources. The unit — and the course — ends with exam day itself: the steps to a license in order, the handbook rules, the strategy for four-choice questions, a two-week review plan, the assembled Pathway File and a full-length practice national exam. Keep your basic calculator beside you; this is the most arithmetic-heavy unit in the course, and every answer can be checked.

PREREQUISITES

- Can convert among fractions, decimals and percents and solve a one-step equation for an unknown
- Can compute NOI from potential gross income, vacancy and operating expenses, from Lessons 4.5 and 9.5
- Can explain debits and credits on a closing statement and prorate an item, from Lesson 6.5
- Has every project from Units 1–9 filed and the exam notebook's trap lists current

MASTERY CHECKLIST

- ☐ I can solve any part–whole–rate problem with the T-bar, including percent of change and original cost from a profit or loss.
- ☐ I can find the area of rectangles, triangles, trapezoids and irregular lots, convert to square yards and acres, and compute volume in cubic yards.
- ☐ I can compute the acreage of a rectangular-survey description, adding parcels joined by "and."
- ☐ I can compute commissions and splits, a net-listing price, points, LTV, a month of interest and principal, and PITI.
- ☐ I can compute property tax in mills and transfer tax, prorate taxes and rent by both the 360-day and 365-day methods, and assign debits and credits correctly.
- ☐ I can compute cap rate, value, GRM, cash flow and cash-on-cash return, and straight-line depreciation at 27.5 or 39 years without depreciating land.
- ☐ I can compute adjusted basis and gain, apply the Section 121 exclusion, and explain a Section 1031 exchange with its 45-day and 180-day deadlines and boot.
- ☐ I can state my own state's licensing requirements from its official agency, list the steps to a license in

order, and sit a full-length timed practice exam with a pacing plan.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **IRS Publication 523: Selling Your Home**: Free, official. The IRS's own explanation of the home-sale exclusion — the ownership and use tests, figuring basis and gain, and worksheets. Use it with Lesson 10.3 and its project extension; read it as education, not as advice for any particular sale. Ages 15 and up.
- **IRS: Like-Kind Exchanges — Real Estate Tax Tips**: Free, official. A short IRS page on Section 1031 exchanges of real property, including the identification and exchange periods. Read it during Lesson 10.3 before writing your exchange paragraph. Ages 15 and up.
- **Washington State Department of Licensing: Get Your License — Real Estate Brokers**: Free, official. Washington's own page on the broker license: age and education, the 90 hours, the PSI exams and their timing, fingerprints and the application. Use it with Lesson 10.4; students in other states should find their own commission's equivalent page. Ages 15 and up.
- **Oregon Real Estate Agency: Broker Licensing**: Free, official. Oregon's step-by-step path to the broker license, from the 150 hours to the PSI exam and association with a principal broker. Use it with Lesson 10.4 as a model of what to look for on any state's site. Ages 15 and up.
- **Idaho Real Estate Commission (DOPL): Education for Applicants**: Free, official. Idaho's description of the two 45-hour salesperson modules and the three-year time limit, with links to the Commission's other licensing pages. Use it with Lesson 10.4's practice set. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

10.1	**The Math Toolkit: Percentages, Area and Acreage**	3 sessions of 50 minutes
10.2	**Money Math: Commissions, Loans, Taxes and Prorations**	3 sessions of 50 minutes
10.3	**Investment Math and the Taxman**	3 sessions of 50 minutes
10.4	**The State Portion: License Law in the Northwest and Beyond**	

Unit 10 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Seventy percent — 14 of 20 — matches the common passing line, but aim higher. Figures marked “in this example” are examples; real commission rates, tax rates and state rules are set by negotiation, by local law and by your state’s licensing agency. Show your work on scratch paper, estimate before you calculate, and choose the one BEST answer.

1. **5 pts**

   A home sold for $378,000, which was 90% of its list price. What was the list price?

   A. $340,200

   B. $415,800

   C. $420,000

   D. $396,900

2. **5 pts**

   How many acres are in the NW¼ of the NE¼ of the SE¼ of a section?

   A. 10

   B. 40

   C. 20

   D. 2.5

3. 5 pts

A lot has two parallel sides of 100 feet and 140 feet, 180 feet apart. What is its area?

A. 25,200 sq ft

B. 21,600 sq ft

C. 18,000 sq ft

D. 12,600 sq ft

4. 5 pts

An owner bought a lot for $250,000 and sold it for $215,000. What was the percent of loss?

A. 16.3%

B. 35%

C. 86%

D. 14%

5. 5 pts

In this example a $380,000 sale carries a 6% commission, split equally between the listing and cooperating brokerages. The cooperating agent receives 60% of her brokerage's share. What does she receive?

A. $6,840

B. $11,400

C. $13,680

D. $4,560

6. 5 pts

A seller wants to net $300,000 after a 5% commission (in this example) and $4,000 of other costs. What is the lowest sale price that does it?

A. $319,200

B. $315,000

C. $320,000

D. $304,000

7. 5 pts

A buyer purchases a $400,000 home with an 85% loan and pays 2 discount points. What do the points cost?

A. $8,000

B. $6,800

C. $3,400

D. $680

8. 5 pts

A property is assessed at $180,000, and the tax rate is 32 mills. What is the annual tax?

A. $576

B. $57,600

C. $3,200

D. $5,760

9. 5 pts

Annual taxes of $3,650 are paid in arrears. Closing is April 11; the buyer owns the day of closing. Using a 365-day year, what is the proration and entry?

A. $1,000, debit buyer and credit seller

B. $1,000, debit seller and credit buyer

C. $1,010, debit seller and credit buyer

D. $2,650, debit seller and credit buyer

10. 5 pts

How much interest is due in the first month on a $250,000 loan at 6% annual interest?

A. $1,250

B. $15,000

C. $1,500

D. $125

11. **5 pts**

A building's NOI is $48,000, and the market cap rate is 8%. What is its value?

A. $384,000

B. $480,000

C. $600,000

D. $640,000

12. **5 pts**

An investor buys a residential rental property for $500,000, of which $115,000 is land value. What is the annual straight-line depreciation?

A. $18,181.82

B. $12,820.51

C. $9,871.79

D. $14,000

13. **5 pts**

A married couple filing jointly, who have owned and lived in their home for six years, realize a gain of $560,000 on its sale. How much of the gain is taxable?

A. $60,000

B. $310,000

C. $0

D. $560,000

14. **5 pts**

In a delayed Section 1031 exchange, the investor must identify replacement property and acquire it within:

A. 30 days and 90 days

B. 45 days and 180 days

C. 60 days and 180 days

D. 45 days and 120 days

15. 5 pts

An owner bought a rental for $220,000, added $30,000 of capital improvements and has taken $40,000 of depreciation. What is the adjusted basis?

A. $290,000

B. $250,000

C. $210,000

D. $180,000

16. 5 pts

A house renting for $2,700 a month sold for $297,000. What is its gross rent multiplier?

A. 9.17

B. 1.1

C. 91.7

D. 110

17. 5 pts

Among Washington, Oregon, Idaho, Montana and Alaska, which state's minimum licensing age is 19, as of 2026?

A. Alaska

B. Oregon

C. Montana

D. Idaho

18. 5 pts

The most reliable source for your state exam's ID rules, calculator policy, passing score and retake rules is:

A. An exam-prep video

B. An online forum

C. The testing vendor's candidate handbook for your state

D. A trade association newsletter

19. 5 pts

On a question asking which choice is NOT true of a topic, the best approach is to:

A. Choose the first true statement you find

B. Treat each choice as true or false and select the false one

C. Choose the longest answer

D. Skip it, since there is a penalty for guessing

20. 5 pts

A concrete patio 30 feet by 20 feet is poured 6 inches thick. About how many cubic yards of concrete are needed?

A. 3,600

B. 100

C. 33.3

D. 11.1

ANSWER KEY

1. C. Whole = part ÷ rate: $\$378{,}000 \div 0.90 = \$420{,}000$. B adds 10% of the sale price, taking the percent of the wrong whole.
2. A. $640 \times \frac{1}{4} \times \frac{1}{4} \times \frac{1}{4} = 10$ acres. B stops after two fractions.
3. B. Trapezoid: $\frac{1}{2} \times (100 + 140) \times 180 = 21{,}600$ sq ft. A uses only the longer side; C only the shorter.
4. D. $(\$250{,}000 - \$215{,}000) \div \$250{,}000 = 0.14$. A divides by the sale price instead of the original cost.
5. A. $\$380{,}000 \times 0.06 = \$22{,}800$; half is $\$11{,}400$; $\$11{,}400 \times 0.60 = \$6{,}840$. C applies 60% to the whole commission.
6. C. $(\$300{,}000 + \$4{,}000) \div 0.95 = \$320{,}000$. A adds 5% to $\$304{,}000$, which leaves the seller $\$760$ short.
7. B. The loan is $\$400{,}000 \times 0.85 = \$340{,}000$, and 2 points are $\$340{,}000 \times 0.02 = \$6{,}800$. A computes points on the price.
8. D. 32 mills = 0.032; $\$180{,}000 \times 0.032 = \$5{,}760$. B treats mills as percent.
9. B. Seller's days: $31 + 28 + 31 + 10 = 100$; $\$3{,}650 \div 365 = \$10$ a day, so $\$1{,}000$. Taxes in arrears are unpaid for the seller's days: debit seller, credit buyer. A reverses the entry.
10. A. $\$250{,}000 \times 0.06 \div 12 = \$1{,}250$. B is a full year's interest.
11. C. Value = NOI ÷ rate: $\$48{,}000 \div 0.08 = \$600{,}000$. A multiplies by the rate instead of dividing by it.
12. D. Land is never depreciated: $(\$500{,}000 - \$115{,}000) \div 27.5 = \$14{,}000$. A includes the land; C uses the 39-year nonresidential life.
13. A. They meet the two-of-five-year test, so up to $\$500{,}000$ is excluded under Section 121: $\$560{,}000 - \$500{,}000 = \$60{,}000$. B applies the single-filer $\$250{,}000$ limit.
14. B. 45 days to identify and 180 days to acquire, counted from the transfer of the property given up.
15. C. $\$220{,}000 + \$30{,}000 - \$40{,}000 = \$210{,}000$. A adds the depreciation instead of subtracting it.
16. D. GRM = price ÷ monthly rent: $\$297{,}000 \div \$2{,}700 = 110$. A divides by annual rent, the gross income multiplier used for commercial property.
17. A. Alaska requires salesperson applicants to be 19; the other four require 18. Always confirm with the state's agency.

18. C. The candidate handbook, linked from the state commission's site, is the official rulebook for the exam; other sources may be outdated or wrong.
19. B. An EXCEPT or NOT question hides three true statements and one false one. D is wrong twice: never skip, and there is no penalty for guessing.
20. D. $30 \times 20 \times 0.5 = 300$ cubic feet; $300 \div 27 \approx 11.1$ cubic yards. A forgets to convert inches to feet; C divides by 9 instead of 27.

PORTFOLIO PIECE: MY PATHWAY FILE — THE MATH PAGES AND THE ROAD AHEAD

Complete your Pathway File with the last unit's work: the Formula Card and the real county parcel measured, converted to acres and compared with the assessor's figure (10.1); the Closing Calculator spreadsheet with its commission, loan, proration and two-sided closing statement blocks, tested against the lesson's examples (10.2); the Investment Analysis Worksheet for a pretend four-unit building, from NOI and cap rate to depreciation, gain and a 1031 paragraph, clearly labeled an educational exercise (10.3); My State Facts Sheet, sourced and dated from your state's agency and candidate handbook (10.4); and the Road-to-License Plan, the exam-day handbook card and the two-week review calendar (10.5).

Then assemble the whole binder — one tab per unit, the formula card and state facts sheet at the front — and add the capstone: your scored, honestly proctored practice final, your score by unit, every miss corrected and explained, and the sealed letter to your future licensed self. Date every page. This binder is the record of a year's work and the beginning of a professional life.

LOOK FOR	WHAT IT MEANS
Formula Card and real parcel	Every toolkit formula appears with a correct example; the parcel is sketched to scale, split into shapes, converted to acres and compared with the assessor's figure with a reasoned explanation of any difference.
Closing Calculator	All blocks use formulas rather than typed numbers; commissions, points, LTV, interest, PITI and both proration methods are correct; the closing statement balances and reproduces the lesson's seller's net and cash to close.
Investment Analysis Worksheet	NOI, value, GRM, cash flow, cash-on-cash return, depreciation (land excluded), adjusted basis and gain are all correct, and the 1031 paragraph uses each required term accurately and labels the work as education, not advice.
State Facts Sheet	All nine state-portion topics are covered with facts taken only from official sources, every fact is dated and cited, and the timeline shows every time limit correctly.
Road-to-License Plan and practice final	The nine steps are adapted to the student's own state with realistic dates; the practice final was taken under honest timed

LOOK FOR	WHAT IT MEANS
	conditions, scored by unit, and every miss is corrected with a reason.
Assembled Pathway File	All ten units are present, tabbed and in lesson order, every page is dated, and the binder reads as a coherent professional record.

10.1 The Math Toolkit: Percentages, Area and Acreage

OBJECTIVES

- Solve any part–whole–rate problem with the T-bar, finding the part, the whole or the rate, and convert freely among fractions, decimals and percents.
- Compute percent of change for appreciation and depreciation, and find an original price from a sale price and a percent of profit or loss.
- Calculate the area of rectangles, triangles, trapezoids and irregular lots divided into shapes, and convert among square feet, square yards and acres.
- Use front feet and price per front foot, and compute volume in cubic feet and cubic yards.
- Find the acreage of rectangular-survey descriptions, including descriptions joined by “and.”

> **Warm-up.** Without a calculator, in five minutes: What is 10% of $350,000? 5%? 1%? What is 25% of 640? How many square feet is a room 12 feet by 15 feet? Write each answer, then write the shortcut you used. The shortcuts are the beginning of exam speed.

WATCH

The T-Method: The Secret That Will Change The Way You Solve Real Estate Math Questions

Just Call Maggie · 8:09

https://www.youtube.com/watch?v=uYVv7t3se1Y

> **WHEN TO WATCH**
> Watch after core idea three; draw the T in your notebook and pause before she solves each problem to solve it yourself first.

BACKUP VIDEO

Real Estate Exam Math / Percentages

PrepAgent · 3:01

https://www.youtube.com/watch?v=DyTuQAPIeOw

A quick review of percents and decimals; watch before the practice set and convert each example to a decimal before he does.

KEY TERMS

T-bar (part–whole–rate)

A diagram relating part, whole and rate: part = whole × rate; cover the unknown to see whether to multiply or divide.

rate

A percent written as a decimal for calculation — 6% is 0.06 — that links a part to its whole.

percent of change

The difference between a new and an old value divided by the old value; positive for appreciation, negative for depreciation or loss.

appreciation

An increase in a property's value over time.

depreciation (in value)

A decrease in a property's value over time from any cause; distinct from tax depreciation.

area

The two-dimensional measure of a surface in square units: square feet, square yards or acres.

acre

A unit of land area equal to 43,560 square feet.

front foot

A linear foot of a lot's frontage along a street or water; frontage is listed first in a lot's dimensions.

volume

The three-dimensional measure of space in cubic units: length × width × height.

cubic yard

A unit of volume equal to 27 cubic feet (3 ft × 3 ft × 3 ft), used to order concrete, gravel and fill.

section

In the rectangular survey, one square mile containing 640 acres; 36 sections make a township.

CORE IDEAS

The story. About 430 B.C., the Greek historian Herodotus traveled in Egypt and wrote down what the priests told him about where measurement of land began. A king, they said, had divided the land of Egypt among his people in equal square plots and taxed each owner every year according to his plot. But the Nile flooded every summer, and sometimes the river carried part of a man's field away. When that happened, the owner reported the loss, and the king sent men to measure how much smaller the land had become, so that the owner would pay a tax in proportion to what remained. From this practice, Herodotus wrote, the Greeks learned the art of measuring land — which is what the word *geometry* literally means. Notice the three ideas in that story: area (how big is the plot?), percentage (what fraction was lost?) and money (how much tax is owed now?). Every math question on a real estate exam is built from those same three, and the rest of this lesson is the toolkit for them.

How they figured it out. The Egyptians had written methods long before Herodotus arrived. The **Rhind Mathematical Papyrus**, copied by a scribe named Ahmes around 1550 B.C. and now in the British Museum, contains worked problems for the area of a rectangular field, a triangular field and a field shaped like a truncated triangle — what we call a **trapezoid**. The scribes had discovered what you will use: break any odd-shaped field into rectangles and triangles, find each area, and add. Percentages arrived later, through medieval merchants who reckoned interest and profit "per

hundred" — *per centum*. Modern exam teachers compressed all of it into a single picture, the **T-bar**: the **part** on top, the **whole** and the **rate** side by side below. Cover the one you want. If the two you know sit side by side, multiply; if one sits on top of the other, divide. Commission, interest, tax, down payment, loan-to-value, cap rate, vacancy — every one of them is a T-bar with a different name.

The big idea. Part = Whole × Rate. Rearranged, **Rate = Part ÷ Whole** and **Whole = Part ÷ Rate**. Before you calculate, convert the percent to a decimal by moving the point two places left: 6% = 0.06, 7.5% = 0.075, ½% = 0.005. Then ask one question: which number is the whole — the thing the percent is *of*? In "the commission is 6% of the sale price," the sale price is the whole. In "the seller received 94% of the price after commission," the price is still the whole and 94% is the rate. A great many exam errors come from treating the part as the whole. Two habits protect you. First, **estimate** before you calculate: 6% of $412,000 must be a little under $25,000, so an answer of $2,472 or $247,200 is wrong before you check it. Second, **label** every number with its unit — dollars, square feet, acres, percent — so you never add square feet to front feet. Fractions convert the same way: ¼ = 0.25 = 25%, ⅛ = 0.125, ⅔ ≈ 0.667.

Percent of change measures appreciation and depreciation: subtract the old value from the new, then divide by the **old** value. A house bought for $240,000 and sold for $276,000 appreciated $36,000 ÷ $240,000 = 15%. The exam's favorite twist runs backward: "A seller sold for $330,000, which was a 10% profit over what she paid. What did she pay?" The sale price is 110% of the cost, so cost = $330,000 ÷ 1.10 = $300,000 — not $330,000 minus 10% of $330,000 ($297,000), which takes the percent of the wrong whole. Likewise a 15% loss means the sale price is 85% of the cost: divide by 0.85. A related trap: a value that falls 20% and then rises 20% does *not* return to where it started, because the second percent is taken of a smaller whole ($100,000 → $80,000 → $96,000). Annual rates compound the same way. When a question says "per year for three years," ask whether it means simple (the same dollar change each year) or compounded (a percent of each new value), and read the answer choices for a clue.

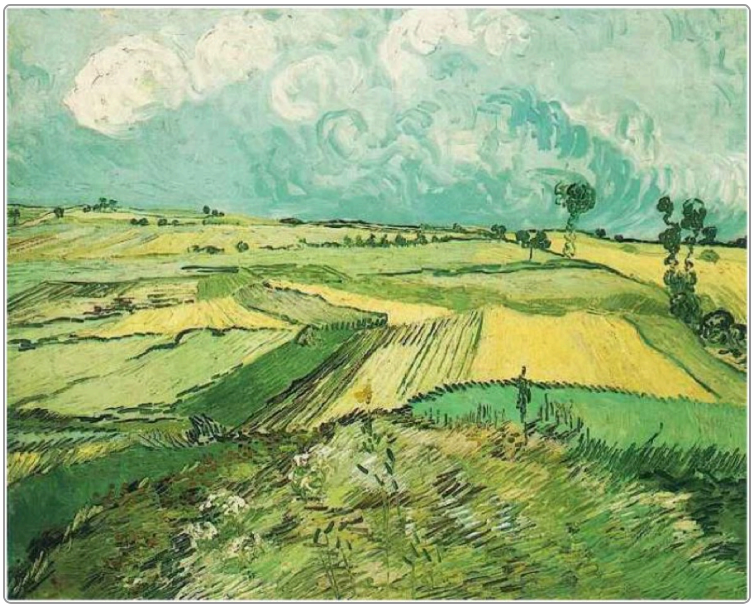
Area is measured in square units. A **rectangle** is length × width. A **triangle** is ½ × base × height, where the height is measured at a right angle to the base. A **trapezoid** — a lot with two parallel sides of different lengths, common on curving streets — is ½ × (side 1 + side 2) × the distance between them. For an **irregular lot**, sketch it, split

it into rectangles and triangles, and add the pieces. Then convert. There are 9 square feet in a square yard (3 × 3), so divide square feet by 9 to get square yards — the unit carpet is sometimes priced in. There are **43,560 square feet in an acre**, so divide square feet by 43,560 to get acres, and multiply acres by 43,560 to get square feet. A **front foot** is a foot of frontage along the street or water, and a lot listed as "100 by 150" has 100 front feet — **frontage is always listed first.** Land priced "per front foot" is priced on that first number alone.

Volume adds a third dimension: length × width × height (or depth), in cubic feet. Concrete, gravel and fill are ordered in **cubic yards**, and a cubic yard is 27 cubic feet (3 × 3 × 3), so divide cubic feet by 27. Watch the units of thickness: a slab 4 *inches* thick is 4/12 = ⅓ of a foot thick, and forgetting to convert inches to feet multiplies the answer by twelve. Then review the **rectangular survey** from Lesson 1.4 with arithmetic eyes. A section is one square mile, **640 acres**; a township is 36 sections. To find the acreage of an aliquot description, multiply 640 by every fraction in it: "the NE¼ of the SW¼ of Section 14" is 640 × ¼ × ¼ = 40 acres. The word **"and"** (or a semicolon) joins separate parcels, so compute each and **add.** Two useful facts for checking: a mile is 5,280 feet, so a section is 5,280 × 5,280 = 27,878,400 square feet, which divided by 43,560 is exactly 640 acres; and a square acre is about 208.71 feet on a side.

On the exam today. Math is a small share of the national exam — 7% of PSI's national outline and 7 of the 80 scored items in Pearson VUE's — but every math question is a point you can earn with certainty, and the toolkit appears inside many others. Expect a percent problem disguised as a commission, a percent-of-change problem, at least one area or acreage problem and possibly a rectangular-survey acreage. The classic traps: **taking the percent of the wrong whole** (the "sold for $330,000 at a 10% profit" question); forgetting to convert **inches to feet** or **square feet to acres**; using the second dimension as the frontage; multiplying the fractions of a survey description when the word "and" told you to add; and using a triangle's slanted side instead of its height. Your defenses are the two habits: **estimate first** and **label every unit.** Use the basic calculator you will have at the testing center, and practice until reaching for the T-bar is automatic.

PICTURE STUDY



Wheat Fields at Auvers Under Clouded Sky, Vincent van Gogh, July 1890 · Oil on canvas · Carnegie Museum of Art, Pittsburgh

Image: Wikimedia Commons, public domain

In the last weeks of his life, in July 1890, Vincent van Gogh painted the wheat fields on the plateau above the village of Auvers-sur-Oise, north of Paris, again and again. Seen from a little height, the farmland becomes a quilt of shapes — long rectangles, slanting wedges, strips that narrow toward the horizon — each one somebody's field, plowed, sown and measured. It opens the math lesson because every patch in it is an area problem: a rectangle, a triangle or a trapezoid that some surveyor once measured and some owner once paid for by the acre.

Look closely

- Find a field that looks like a rectangle, one like a triangle and one like a trapezoid. Real parcels are rarely perfect shapes; the surveyor splits them into pieces.
- Look at how the strips narrow as they go back toward the horizon. Perspective changes how land looks, never how much there is — that is why we measure instead of guessing.
- Notice the colors: ripe yellow beside green. Different fields, different crops, different owners — and different values per acre.

- Look at the sky, which takes up nearly half the canvas. Van Gogh measured nothing here; he painted what the measurers walk across.

Talk about it

1. If the yellow field in the center were 300 feet across the front, 500 feet across the back and 400 feet deep, how many acres would it hold?
2. Why do you think Van Gogh chose to paint fields from a height, where their shapes show, rather than from inside the wheat?
3. Deuteronomy 25:15 commands “a perfect and just measure.” Why does honest measurement of land matter so much to a buyer, a seller and a neighbor?

PROJECT

The Formula Card and a Real Parcel

You will build the single most useful page in your Pathway File for exam week: a one-page formula card with every toolkit formula and a worked example beside each. Then you will test the toolkit on a real parcel from your own county's public parcel map — measuring it, computing its area and acreage, and comparing your answer with the assessor's figure.

You will need

- Your county assessor's online parcel map (free and public)
- Graph paper, a ruler and a basic calculator
- One index card or half-sheet for the formula card
- Your exam notebook

Steps

1. On the formula card, write the T-bar and its three forms, percent of change, original cost from a profit or loss, the three area formulas, square yards, acres, volume and cubic yards, and the 640-acre rule — each with a one-line example of your own.
2. On the county parcel map, choose one parcel (a park, a school lot or your own home's lot). Record only its parcel number, the dimensions shown on the map and the assessor's stated acreage — no owner's name.
3. Sketch the parcel to scale on graph paper. If it is irregular, split it into rectangles and triangles and label every piece with its dimensions.
4. Compute each piece's area, add them, and convert the total to acres. Show every step with units.
5. Compare your acreage with the assessor's figure. Compute the percent difference: (your figure − assessor's) ÷ assessor's. Write two sentences on why they might differ (rounded dimensions, curved lines, rights-of-way).
6. If the parcel fronts a street, record its front feet and compute a pretend price at $900 per front foot (in this example) and the price per square foot that implies.

7. Title the pages “Formula Card” and “A Real Parcel,” date them and file them.

EXAM NOTEBOOK

1. Draw a large T-bar with PART on top and WHOLE × RATE below, and around it write six real estate words that use it: commission, interest, tax, down payment, LTV, cap rate.
2. Draw a rectangle, a triangle and a trapezoid with their area formulas, and under them the conversion ladder: sq ft ÷ 9 = sq yd; sq ft ÷ 43,560 = acres; cu ft ÷ 27 = cu yd.
3. Trap list titled “Wrong whole”: profit/loss questions divide by (1 ± rate); “100 × 150” has 100 front feet; inches ÷ 12 before multiplying; “and” means add.

KEY FORMULAS

$$\text{Part} = \text{Whole} \times \text{Rate} \qquad \text{Rate} = \frac{\text{Part}}{\text{Whole}} \qquad \text{Whole} = \frac{\text{Part}}{\text{Rate}}$$

$$\text{Percent of change} = \frac{\text{New value} - \text{Old value}}{\text{Old value}}$$

$$\text{Original cost} = \frac{\text{Sale price}}{1 + \text{profit rate}} \quad \text{or} \quad \frac{\text{Sale price}}{1 - \text{loss rate}}$$

$$A_{\text{rectangle}} = L \times W \qquad A_{\text{triangle}} = \tfrac{1}{2} \times b \times h \qquad A_{\text{trapezoid}} = \tfrac{1}{2}(b_1 + b_2) \times h$$

$$\text{Square yards} = \frac{\text{Square feet}}{9} \qquad \text{Acres} = \frac{\text{Square feet}}{43{,}560}$$

$$V = L \times W \times H \qquad \text{Cubic yards} = \frac{\text{Cubic feet}}{27}$$

$$\text{Acres in an aliquot part} = 640 \times (\text{each fraction in the description})$$

From history. The Rhind Mathematical Papyrus takes its name from Alexander Henry Rhind, a young Scottish antiquarian who bought it in Luxor in 1858; it passed to the British Museum after his early death. Its scribe, Ahmes, opened with a grand promise of knowledge of all things, and then got down to business — dividing loaves among workers, figuring the volume of granaries and measuring fields. It is one of the oldest surviving math textbooks, and much of it would fit comfortably in a real estate math chapter.

WORKED EXAMPLES

Example 1. A seller sold her house for $345,000, which was a 15% profit over what she paid. What did she pay, and what was her profit in dollars?

Show solution

1. Identify the whole: the percent is of what she *paid*, so the sale price is 100% + 15% = 115% of the cost.
2. Whole = Part ÷ Rate: $\$345{,}000 \div 1.15 = \$300{,}000$.
3. Profit: $\$345{,}000 - \$300{,}000 = \$45{,}000$.
4. Check: $\$45{,}000 \div \$300{,}000 = 0.15 = 15\%$. (The trap answer, $\$345{,}000 \times 0.85 = \$293{,}250$, takes 15% of the wrong whole.)

Answer: She paid $300,000 and made a $45,000 profit.

Example 2. A lot on a curving street is a trapezoid: the front line is 120 feet, the parallel back line is 180 feet, and the lot is 200 feet deep (measured at right angles between them). Find its area in square feet and acres, and its price at $3.50 per square foot.

Show solution

1. Trapezoid area: $\frac{1}{2} \times (120 + 180) \times 200 = \frac{1}{2} \times 300 \times 200 = 30{,}000$ sq ft.
2. Acres: $30{,}000 \div 43{,}560 \approx 0.69$ acre.
3. Price: $30{,}000 \times \$3.50 = \$105{,}000$.
4. Estimate check: an acre is about 43,600 sq ft, and 30,000 is a bit over two-thirds of that — 0.69 is reasonable.

Answer: 30,000 square feet, about 0.69 acre, priced at $105,000.

Example 3. A farm is described as "the S½ of the NE¼ and the NW¼ of the SE¼ of Section 10." How many acres is it, how many square feet, and what is it worth at $4,500 per acre (in this example)?

Show solution

1. The word "and" joins two parcels — compute each and add.
2. First parcel: $640 \times \frac{1}{4} \times \frac{1}{2} = 80$ acres; second: $640 \times \frac{1}{4} \times \frac{1}{4} = 40$ acres.
3. Total: $80 + 40 = 120$ acres; square feet: $120 \times 43{,}560 = 5{,}227{,}200$ sq ft.
4. Value: $120 \times \$4{,}500 = \$540{,}000$.

Answer: 120 acres (5,227,200 square feet), worth $540,000 at $4,500 an acre.

PRACTICE

1. Easy What is 25% of $380,000?

   Show answer

   $\$380{,}000 \times 0.25 = \$95{,}000.$

2. Easy A rectangular lot is 90 feet by 140 feet. What is its area?

   Show answer

   $90 \times 140 = 12{,}600$ sq ft.

3. Easy How many acres are in the NE¼ of the SW¼ of a section?

   Show answer

   $640 \times \frac{1}{4} \times \frac{1}{4} = 40$ acres.

4. Medium A home sold for $315,000, which was 90% of its list price. What was the list price?

   Show answer

   Whole = Part ÷ Rate: $\$315{,}000 \div 0.90 = \$350{,}000.$

5. Medium A triangular lot has a base of 210 feet and a height of 150 feet. Find its area in square feet and acres.

   Show answer

   $\frac{1}{2} \times 210 \times 150 = 15{,}750$ sq ft; $15{,}750 \div 43{,}560 \approx 0.36$ acre.

6. **Medium** How many square feet are in 2.5 acres?

   Show answer

   $2.5 \times 43{,}560 = 108{,}900$ sq ft.

7. **Medium** A driveway 60 feet long and 12 feet wide is to be poured 4 inches thick. How many cubic yards of concrete are needed?

   Show answer

   $60 \times 12 \times \frac{4}{12} = 240$ cu ft; $240 \div 27 \approx 8.89$ cubic yards — order 9.

8. **Hard** An investor bought land for \$80,000 and sold it for \$68,000. What was the percent of loss?

   Show answer

   $(\$68{,}000 - \$80{,}000) \div \$80{,}000 = -0.15$, a 15% loss — divided by the original \$80,000, not the sale price.

9. **Hard** A lot measuring 150 feet by 300 feet sells at \$1,200 per front foot. What is the price, and what price per square foot does that equal?

   Show answer

   Frontage is the first number: $150 \times \$1{,}200 = \$180{,}000$. Area $= 150 \times 300 = 45{,}000$ sq ft, so $\$180{,}000 \div 45{,}000 = \$4.00$ per sq ft.

10. **Hard** A room 15 feet by 18 feet is carpeted at \$36 per square yard installed. What is the cost?

    Show answer

    $15 \times 18 = 270$ sq ft; $270 \div 9 = 30$ sq yd; $30 \times \$36 = \$1{,}080$.

11. **Challenge** A house sold for \$412,500, giving the seller a 25% profit over her cost. Another seller sold for \$412,500 at a 25% loss. What did each pay?

    Show answer

    Profit: $\$412{,}500 \div 1.25 = \$330{,}000$. Loss: $\$412{,}500 \div 0.75 = \$550{,}000$. In both, the percent is of the cost, so divide by (1 ± rate).

12. **Challenge** A square lot contains exactly one acre. How long is each side, and what would fencing all four sides cost at $12 per linear foot?

Show answer

Side $= \sqrt{43{,}560} \approx 208.71$ ft; perimeter $\approx 4 \times 208.71 = 834.84$ ft; cost $\approx 834.84 \times \$12 = \$10{,}018.08$.

COMMON MISTAKES

- Taking a profit or loss percent of the sale price instead of the cost — divide the sale price by (1 + profit rate) or (1 − loss rate).
- Dividing percent of change by the new value — always divide by the old (original) value.
- Forgetting to convert inches to feet before computing volume, or cubic feet to cubic yards (÷ 27).
- Using the depth instead of the frontage — in "100 × 150," the first number is the front feet.
- Multiplying the fractions of two parcels joined by "and" — compute each parcel and add.
- Using a triangle's slanted side as its height — the height is measured at a right angle to the base.

Make it a game · Acre Race. Write twelve rectangular-survey descriptions on cards — "NE¼ of SW¼," "N½ of NW¼," "S½ of NE¼ and NW¼ of SE¼," "W½ of the E½ of the NW¼." Players race to call out the acreage first; one point for speed, but a wrong answer costs a point. Then flip to the back of each card, where you have written a price per acre, and race again to call out the value. For a lightning round, call out a number of square feet and race to the nearest tenth of an acre. Ten minutes; the champion is crowned Surveyor General for the day.

Scripture. "But thou shalt have a perfect and just weight, a perfect and just measure shalt thou have: that thy days may be lengthened in the land which the LORD thy God giveth thee." (Deuteronomy 25:15, KJV)

Israel's law tied honest measurement to life in the land itself. Every figure a licensee states — a lot's acreage, a room's square footage, a percent of appreciation — is a measure someone will rely on, and getting it right, or saying plainly when it has not been verified, is a modern form of the just measure.

10.2 Money Math: Commissions, Loans, Taxes and Prorations

OBJECTIVES

- Compute total commissions, brokerage-to-brokerage and broker-to-agent splits, and tiered (graduated) commissions.
- Find the listing price needed to net a seller a target amount after commission and costs, using net ÷ (1 − rate).
- Calculate loan-to-value, down payment, discount points, a month of interest and principal, PITI and a housing ratio.
- Compute property tax with mills and a transfer tax charged per $500 or $1,000 of price.
- Prorate taxes and rent by the 360-day and 365-day methods, assign each item as a debit or credit, and compute a seller's net and a buyer's cash to close.

> **Warm-up.** On a sheet of paper, draw two columns headed BUYER and SELLER. In five minutes, list where each of these goes — and whether that person pays it or receives it: the purchase price, the new loan, the earnest money, the commission, the seller's old loan payoff. Guess where you are unsure; core idea six will check you.

WATCH

The 10 Most Common Real Estate Math Formulas You Need to Know | Just Call Maggie

Just Call Maggie · 10:48

https://www.youtube.com/watch?v=LIXlHPX3AjQ

> **WHEN TO WATCH**
> Watch after core idea five; write each formula as she names it, then check it against this lesson's formula list and circle any you had not yet memorized.

BACKUP VIDEO

How to Solve Real Estate Math Commission Exam Questions | PrepAgent Explanations and Answers

PrepAgent · 9:43

https://www.youtube.com/watch?v=bE2vmxk-4d8

Watch before practice problems 1 and 4; work each commission question on paper before he explains it, and check that you took the percent of the right whole.

KEY TERMS

commission split

The division of a commission — between the listing and cooperating brokerages, and then between each brokerage and its agent — by percentages agreed in advance.

graduated (tiered) commission

A commission computed at different rates on different portions of the price, such as one rate on the first $100,000 and another on the rest.

net listing price formula

The price needed to give a seller a target net: (desired net + seller's costs) ÷ (1 − commission rate).

loan-to-value ratio (LTV)

The loan amount divided by the lesser of the purchase price or appraised value.

discount point

A charge equal to 1% of the loan amount, paid to the lender to lower the interest rate.

PITI

Principal, interest, taxes and insurance — the full monthly housing payment used in qualifying.

mill

One-tenth of a cent, $0.001; a tax rate of 25 mills means $25 of tax per $1,000 of assessed value.

transfer tax

A state or local tax on the conveyance of real property, commonly charged per $500 or $1,000 of price; rates and who pays vary by place.

proration

The division of an expense or income item between buyer and seller according to the days each is responsible for it.

debit

On a closing statement, an amount a party owes or is charged.

credit

On a closing statement, an amount a party receives or is credited.

paid in arrears

Paid at the end of the period it covers, such as property taxes in many places and mortgage interest; the seller owes the buyer for the seller's unpaid days.

CORE IDEAS

The story. In 1494 a Franciscan friar and mathematics teacher named Luca Pacioli published in Venice a thick printed book, *Summa de arithmetica, geometria, proportioni et proportionalita* — everything known about arithmetic, geometry and proportion. Tucked inside was a short treatise on bookkeeping as the merchants of Venice practiced it: every transaction written twice, once as a **debit** and once as a **credit**, so that the books must balance and any error shows itself. Pacioli did not invent double entry — Italian merchants had used it for generations — but his was the first printed explanation of it, and it spread across Europe with the new printing presses. Five centuries later, every real estate closing in America is settled on a statement built on the same idea: each item is a debit to one party and a credit to the other, or a debit or credit to one party alone, and the columns must balance to the penny. This lesson gathers all the money math of the course — commissions, loan costs, taxes and prorations — and ends where Pacioli did, with balanced books.

How they figured it out. Pacioli stood on the shoulders of Leonardo of Pisa, called Fibonacci, whose *Liber Abaci* of 1202 had taught Europe the Hindu-Arabic numerals and filled its pages with merchants' problems — partnerships, exchange rates,

interest, the division of profits. Notice what those merchants had learned: almost every commercial calculation is a percentage of something, and the hard part is never the arithmetic but knowing **what the percentage is of**. That is still true. A commission is a percent of the **sale price**. A point is a percent of the **loan**, not the price. Loan-to-value is the loan over the **lesser** of price or appraised value. A management fee is a percent of rent **collected**. A tax rate is applied to **assessed** value, not market value. The T-bar from Lesson 10.1 does all the work; your job is to choose the right whole. The rest is careful, labeled bookkeeping — exactly what Fibonacci's and Pacioli's students practiced in the counting houses of Pisa and Venice.

The big idea. Commission = sale price × rate. Commissions are negotiable between broker and client and are never set by law or by any association, so every rate in this lesson is an example. A **split** is a percentage of a percentage: if a $425,000 home sells at a 6% commission in this example, the total is $25,500; if the listing and cooperating brokerages split it equally, each receives $12,750; if the cooperating agent's agreement with her broker gives her 70%, she receives $8,925 and her broker keeps $3,825. Work the splits in order, from the total down. A **graduated** commission applies different rates to different slices: 7% on the first $100,000 and 3% on the rest of a $350,000 sale is $7,000 + $7,500 = $14,500. The **net listing price** problem asks the reverse: what price gives the seller a target amount after commission and costs? Because the commission is a percent of the *price*, the seller keeps (1 − rate) of it: **price = (desired net + seller's costs) ÷ (1 − commission rate)**. The trap answer adds the commission percent to the net, which always comes up short.

Loan math uses the same tool. The **loan-to-value ratio** is the loan divided by the **lesser** of the purchase price or the appraised value; the **down payment** is the price minus the loan. A **discount point** is 1% of the **loan** — two points on a $280,000 loan cost $5,600. Annual simple interest is loan × rate; the month's interest is that divided by 12. In an amortized loan, each payment pays the month's interest first and the remainder reduces the principal: on a $300,000 loan at 6.5% (in this example) with a principal-and-interest payment of $1,896.20, the first month's interest is $300,000 × 0.065 ÷ 12 = $1,625, the principal paid is $271.20, and the new balance is $299,728.80. The next month's interest is computed on the smaller balance, which is why the principal portion grows. **PITI** adds one-twelfth of the annual property tax and insurance to the principal and interest. A lender compares PITI to gross monthly

income (the **housing ratio**) and all monthly debts to income (the **total debt ratio**); 28% and 36% are traditional examples, not rules — lenders and loan programs set their own.

Taxes come next. Property tax = **assessed value × tax rate**. A rate in **mills** converts by dividing by 1,000: 28 mills = 0.028, so a home assessed at $250,000 owes $7,000. A rate "per $100" divides by 100; "per $1,000" divides by 1,000. A **transfer tax** (also called a documentary stamp or excise tax) is charged on conveyances where state or local law imposes it, often per $500 or $1,000 of price, and the exam will give you the rate. When a rate is per $500 "or fraction thereof," round the number of units **up**: a $412,300 sale is 824.6 units of $500, which becomes 825 units; at $1.10 per unit (in this example), the tax is $907.50. Which party pays transfer tax is set by local law, custom and the contract. Then **prorations**: find a **daily rate** and multiply by the days owed. The **360-day** (statutory or banker's) year treats every month as 30 days; the **365-day** year uses actual days in each month. Who is charged for the **day of closing** varies by state and contract — the question will tell you, and many contracts assign it to the buyer.

Every proration ends with one decision: who gets the debit and who gets the credit? Ask two questions: **who has paid**, and **who should have paid**? Property taxes paid **in arrears** have not yet been paid for the seller's days, so the seller owes the buyer: **debit seller, credit buyer**. Taxes the seller **prepaid** for the whole year cover days the buyer will own, so the buyer reimburses the seller: **debit buyer, credit seller**. Rent the seller collected in advance belongs partly to the buyer: **debit seller, credit buyer**. Some items appear on one side only. The purchase price is a debit to the buyer and a credit to the seller. The new loan and the earnest money are credits to the buyer (money that has been or will be provided on the buyer's behalf). The commission, the seller's loan payoff and the seller's share of costs are debits to the seller. Then **seller's net = seller's credits − seller's debits**, and **buyer's cash to close = buyer's debits − buyer's credits**. Like Pacioli's ledgers, each column must add up exactly.

On the exam today. Expect several of these in every form: a straight commission, a split or two, a net-listing problem, points, LTV, a month of interest, a tax in mills and a proration. The traps are predictable. **Points are on the loan, not the price. LTV uses the lesser of price or appraisal. Net listing: divide by (1 − rate); never add the percent. Mills ÷ 1,000.** In a proration, read the question for the year (360 or 365), for who owns the day of closing, and for whether the item was paid **in arrears** or **in**

advance — that one word flips the debit and credit. A question that says “the seller has not yet paid this year’s taxes” is an arrears question: debit seller, credit buyer. Round only at the end; carrying a rounded daily rate through 165 days can move the answer by a dollar and off the correct choice. Finally, remember why this matters beyond the exam: the closing statement is the family’s money, and every number on it should be one you can check.

PICTURE STUDY



Portrait of Fra Luca Pacioli and an Unknown Young Man, Attributed to Jacopo de' Barbari, 1495 · Oil on panel · Museo di Capodimonte, Naples

Image: Wikimedia Commons, public domain

Painted the year after Pacioli's *Summa* appeared, this portrait shows the friar at work as a teacher of mathematics, demonstrating a proposition of Euclid on a slate while a young man — perhaps a student or patron — looks out at us. The painting is crowded with the tools of exact thinking: compasses, a pen and inkwell, a book of geometry, and a hanging glass solid whose many faces reflect the light. It opens the money-math lesson because Pacioli's great gift to commerce was exactness — every number written twice, every account balanced — and that is the discipline a closing statement still requires.

Look closely

- Find the slate with EVCLIDES written on its edge. Pacioli is teaching geometry, the mathematics of land and measure.
- Look at the glass polyhedron hanging in the air, half full of water. Count how many faces you can see. The painter is showing off precision, too.
- Notice the compasses and the pen near the front of the table — instruments for measuring and for recording. A closing needs both.
- Compare the two faces. The friar looks steadily ahead, intent on his proof; the young man looks out at the viewer. Which of them seems to be learning?

Talk about it

1. Pacioli's bookkeeping rule was that every entry appears twice so that errors reveal themselves. How does a closing statement's balancing of debits and credits protect a buyer and a seller?
2. Why might a merchant of 1494 trust a partner more if the partner kept double-entry books?
3. Proverbs 11:1 calls a false balance an abomination and a just weight God's delight. Where in a real estate closing could a "false balance" hide, and how does careful arithmetic guard against it?

PROJECT

The Closing Calculator

You will build a spreadsheet that does the money math of a whole transaction: commission and splits, a net-listing price, loan figures with PITI, a tax proration by both methods, and a two-column closing statement that produces a seller's net and a buyer's cash to close. When you can type in a new price and watch every number update correctly, you understand the arithmetic of a closing. It goes into your Pathway File beside the Unit 6 closing pages.

You will need

- Free spreadsheet software
- A basic calculator for checking
- Your Lesson 6.5 closing notes (if you have them)
- Your exam notebook

Steps

1. INPUTS block: price, commission rate, cooperating split, agent split, loan-to-value, interest rate, P&I payment (given as an example), annual taxes, annual insurance, closing date, seller's loan payoff, earnest money and a transfer-tax rate per $500 — all pretend numbers.
2. COMMISSION block: total, each brokerage's share and each agent's share, with formulas, not typed numbers.
3. LOAN block: loan amount, down payment, cost of 1.5 points, the first month's interest and principal, the new balance and PITI.
4. PRORATION block: count the seller's days by both the 365-day and 360-day methods (state your day-of-closing convention in a note) and compute both prorations.
5. CLOSING STATEMENT: two columns each for buyer and seller (DEBIT, CREDIT). Enter the price, loan, earnest money, commission, payoff, tax proration and transfer tax (assign it as your pretend contract says), then compute the seller's net and the buyer's cash to close.

6. Test it: set the inputs to this lesson's worked examples and practice problems 11 and 12 and confirm every answer matches. Fix any formula that does not.
7. Title the sheet "Closing Calculator," date it and file a printout.

EXAM NOTEBOOK

1. Flashcards: points (1% of the LOAN), LTV (loan ÷ LESSER of price or appraisal), mills (÷ 1,000), net listing ((net + costs) ÷ (1 − rate)).
2. Draw a closing statement skeleton — BUYER debit/credit and SELLER debit/credit — and place price, loan, earnest money, commission, payoff, prepaid taxes and arrears taxes in the right boxes.
3. Trap list titled "Which whole?": commission of price; points of loan; LTV of the lesser value; tax of assessed value; management fee of collected rent.

KEY FORMULAS

$$\text{Commission} = \text{Sale price} \times \text{Rate}$$

$$\text{Listing price for a target net} = \frac{\text{Desired net} + \text{Seller's costs}}{1 - \text{Commission rate}}$$

$$\text{LTV} = \frac{\text{Loan}}{\text{Lesser of price or appraised value}} \qquad \text{Down payment} = \text{Price} - \text{Loan}$$

$$\text{Cost of points} = \text{Loan} \times (\text{Points} \times 0.01)$$

$$\text{Month's interest} = \frac{\text{Balance} \times \text{Annual rate}}{12} \qquad \text{Principal paid} = \text{P\&I payment} - \text{Month's interest}$$

$$\text{PITI} = \text{P\&I} + \frac{\text{Annual taxes}}{12} + \frac{\text{Annual insurance}}{12}$$

$$\text{Property tax} = \text{Assessed value} \times \frac{\text{Mills}}{1{,}000}$$

$$\text{Daily rate} = \frac{\text{Annual amount}}{360 \text{ or } 365} \qquad \text{Proration} = \text{Daily rate} \times \text{Days}$$

From history. Leonardo of Pisa's *Liber Abaci* (1202) is remembered today for the rabbit puzzle that produces the Fibonacci sequence, but most of its pages were written for merchants: converting weights and currencies, sharing profits among partners, computing interest. It persuaded Italian traders to give up Roman numerals and the counting board for the ten digits we use now. Without that change, the percentages, prorations and balanced ledgers of a modern closing would be almost impossible to write down, let alone check.

WORKED EXAMPLES

Example 1. A $425,000 home sells. In this example the listing agreement provides a 6% commission, the listing brokerage offers the cooperating brokerage half, and the cooperating agent receives 70% of her firm's share. What does each party receive?

Show solution

1. Total commission: $\$425{,}000 \times 0.06 = \$25{,}500$.
2. Brokerage split: $\$25{,}500 \times 0.50 = \$12{,}750$ to each brokerage.
3. Agent's share: $\$12{,}750 \times 0.70 = \$8{,}925$.
4. Her broker keeps $\$12{,}750 - \$8{,}925 = \$3{,}825$.

Answer: Each brokerage receives $12,750; the cooperating agent receives $8,925 and her broker $3,825.

Example 2. A seller wants to net $380,000 after paying a 5% commission (in this example) and $4,750 of other closing costs. What is the lowest price that does it?

Show solution

1. Add the costs to the desired net: $\$380{,}000 + \$4{,}750 = \$384{,}750$.
2. The seller keeps 95% of the price: $1 - 0.05 = 0.95$.
3. Price: $\$384{,}750 \div 0.95 = \$405{,}000$.
4. Check: $\$405{,}000 - (0.05 \times \$405{,}000) - \$4{,}750 = \$405{,}000 - \$20{,}250 - \$4{,}750 = \$380{,}000$.

Answer: $405,000. The trap answer, $384,750 × 1.05 = $403,987.50, leaves the seller short.

Example 3. Annual property taxes of $4,380 have not yet been paid (they are paid in arrears). Closing is June 15; in this example the buyer owns the day of closing. Prorate the taxes by the 365-day and 360-day methods and enter them on the closing statement.

Show solution

1. Seller's days: January 1 through June 14. Actual days: $31 + 28 + 31 + 30 + 31 + 14 = 165$; banker's days: $5 \times 30 + 14 = 164$.
2. 365-day method: $\$4{,}380 \div 365 = \$12.00$ a day; $165 \times \$12.00 = \$1{,}980.00$.
3. 360-day method: $\$4{,}380 \div 360 \approx \$12.1667$ a day; $164 \times \$4{,}380 \div 360 = \$1{,}995.33$.
4. Arrears: the seller has not paid for his days, so the buyer will pay the whole bill later — debit the seller and credit the buyer.

Answer: Debit seller and credit buyer $1,980.00 (365-day year) or $1,995.33 (360-day year).

PRACTICE

1. Easy In this example a home sells for $360,000 at a 5.5% commission. What is the commission?

   Show answer

   $\$360{,}000 \times 0.055 = \$19{,}800$.

2. Easy What do 2.5 discount points cost on a $280,000 loan?

   Show answer

   $\$280{,}000 \times 0.025 = \$7{,}000$ — points are a percent of the loan.

3. Easy A home is assessed at $250,000 and the tax rate is 28 mills. What is the annual tax?

   Show answer

   $\$250{,}000 \times 0.028 = \$7{,}000$.

4. Medium A listing pays 7% on the first $100,000 of price and 3% on the remainder. The home sells for $350,000. What is the commission?

   Show answer

   $\$100{,}000 \times 0.07 = \$7{,}000$; $\$250{,}000 \times 0.03 = \$7{,}500$; total $14,500.

5. Medium A buyer contracts to pay $450,000; the appraisal comes in at $440,000; the lender lends $352,000. What is the LTV, and what is the down payment?

Show answer

LTV uses the lesser value: $\$352{,}000 \div \$440{,}000 = 80\%$. Down payment $= \$450{,}000 - \$352{,}000 = \$98{,}000$.

6. Medium A $300,000 loan at 6.5% has a P&I payment of $1,896.20 (in this example). How much of the first payment is interest, how much principal, and what is the new balance?

Show answer

Interest $= \$300{,}000 \times 0.065 \div 12 = \$1{,}625$; principal $= \$1{,}896.20 - \$1{,}625 = \$271.20$; new balance $299,728.80.

7. Medium The seller collected September's $1,800 rent on September 1. Closing is September 18, and the buyer owns the day of closing. Using a 30-day month, prorate the rent and say who is debited.

Show answer

Buyer's days: September 18–30 = 13 days. $\$1{,}800 \div 30 \times 13 = \$780$. The seller holds rent that belongs to the buyer: debit seller, credit buyer $780.

8. Hard A seller wants to net $250,000 after a 6% commission and $3,500 in other costs. What must the home sell for (to the nearest dollar)?

Show answer

$(\$250{,}000 + \$3{,}500) \div 0.94 = \$269{,}680.85$, about $269,681.

9. Hard In this example a transfer tax is $1.10 per $500 of price or fraction thereof. What is the tax on a $412,300 sale?

Show answer

$\$412{,}300 \div \$500 = 824.6$, rounded up to 825 units; $825 \times \$1.10 = \$907.50$.

10. Hard A buyer's P&I is $1,896.20, annual taxes are $4,800 and annual insurance is $1,440. Gross monthly income is $9,000. Find PITI and the housing ratio, and compare it with a 28% example threshold.

Show answer

PITI $= \$1{,}896.20 + \$400 + \$120 = \$2{,}416.20$. Housing ratio $= \$2{,}416.20 \div \$9{,}000 \approx 26.8\%$, under the 28% example.

11. **Challenge** Seller's net sheet: price $400,000; 6% commission (in this example); loan payoff $212,000; other seller costs $3,200; and a tax proration debit of $1,980. What does the seller net?

    Show answer

    Credits: $400,000. Debits: $24,000 + $212,000 + $3,200 + $1,980 = $241,180. Net = $400,000 − $241,180 = $158,820.

12. **Challenge** Same sale, buyer's side: an 80% loan, $10,000 earnest money already deposited, $8,500 in buyer closing costs, and the $1,980 tax proration credit. What is the buyer's cash to close?

    Show answer

    Debits: $400,000 + $8,500 = $408,500. Credits: $320,000 + $10,000 + $1,980 = $331,980. Cash to close = $408,500 − $331,980 = $76,520.

COMMON MISTAKES

- Computing points on the price instead of the loan amount.
- Using the higher of price and appraisal for LTV — lenders use the lesser.
- Solving a net-listing problem by adding the commission percent to the net instead of dividing by (1 − rate).
- Treating mills as percent — 25 mills is 0.025, not 0.25.
- Reversing the proration entry: taxes in arrears are a debit to the seller and a credit to the buyer; prepaid taxes are the opposite.
- Rounding the daily rate early and carrying the error through many days.

> **Make it a game · Debit or Credit?.** Make sixteen cards, each naming a closing item: purchase price, new loan, earnest money, commission, seller's payoff, taxes paid in arrears, taxes prepaid, rent collected in advance, buyer's title policy, transfer tax per the contract. The caller draws a card and names a party; players hold up a red card (DEBIT) or a green card (CREDIT) — or a gray card if the item does not appear for that party. One point each. Then roll two dice for a closing date in June and race to prorate $3,650 of arrears taxes by the 365-day method ($10 a day makes it quick). Ten minutes.

> **Scripture.** “A false balance is abomination to the LORD: but a just weight is his delight.” (Proverbs 11:1, KJV)
>
> The merchant’s balance scale was the closing statement of the ancient world, and Scripture treats tampering with it as a moral matter, not a technical one. A licensee who checks every proration and every split, and who will not let an error stand because it favors a client, is keeping a just weight.

10.3 Investment Math and the Taxman

OBJECTIVES

- Compute return on investment, cash flow, cash-on-cash return, capitalization rate, value from NOI and the gross rent multiplier.
- Calculate straight-line tax depreciation for residential rental (27.5 years) and nonresidential (39 years) property, excluding land.
- Find basis, adjusted basis, amount realized and capital gain, and distinguish short-term from long-term gain in concept.
- Apply the Section 121 home-sale exclusion ($250,000 / $500,000; two-of-five-year test) to a sale.
- Explain a Section 1031 like-kind exchange (45-day identification, 180-day closing, boot, carried-over basis) and an installment sale — as exam knowledge, not tax advice.

> **Warm-up.** In five minutes, answer in a sentence each: If you buy a bicycle for $400 and sell it two years later for $300, did you have income? If you buy a house for $300,000, spend $40,000 on a new kitchen, and sell it for $400,000, what did you "make"? Write your guess for the second one; you will compute the real answer in core idea five.

WATCH

A-Ha! Real Estate Exam Prep: Capital Gain, Basis, and Adjusted Basis

A-Ha! Real Estate Exam Prep · 16:41

https://www.youtube.com/watch?v=_8u8abzrV3E

> **WHEN TO WATCH**
> Watch after core idea five; pause at each example to compute adjusted basis and gain yourself before he does, and note anything he says that differs from this lesson.

BACKUP VIDEO

1031 Exchanges | Real Estate Exam Prep Concepts

PrepAgent · 3:51

https://www.youtube.com/watch?v=5W3CA0VADVs

A short review of the exchange rules; watch before practice problem 10 and write down the 45-day and 180-day deadlines and the meaning of boot as he states them.

KEY TERMS

cash flow

Net operating income minus debt service — the cash an investment property produces before income taxes.

cash-on-cash return

Annual before-tax cash flow divided by the cash the investor actually put in (down payment plus acquisition costs).

capitalization rate

Net operating income divided by value or price; used to convert income into value (value = NOI ÷ cap rate).

gross rent multiplier (GRM)

Sale price divided by gross monthly rent, used to estimate the value of small residential income properties.

depreciation (cost recovery)

A tax deduction that recovers the cost of a building used in a business or held for investment over its statutory life; land is never depreciated.

basis

A property's starting value for tax purposes, generally the purchase price plus certain acquisition costs.

adjusted basis

Basis plus capital improvements minus depreciation taken (and certain other adjustments).

amount realized

The sale price minus selling expenses such as commission and seller closing costs.

capital gain

Amount realized minus adjusted basis; long-term if the property was held more than one year, short-term if one year or less.

Section 121 exclusion

Exclusion of up to $250,000 of gain ($500,000 for married couples filing jointly) on the sale of a main home owned and used as a principal residence for at least two of the five years before the sale.

Section 1031 exchange

A tax-deferred exchange of real property held for investment or business use for like-kind real property, with 45 days to identify and 180 days to acquire the replacement.

boot

Cash or other non-like-kind property (including debt relief) received in an exchange; it is taxable up to the amount of the gain.

CORE IDEAS

The story. On February 3, 1913, the Sixteenth Amendment to the Constitution was ratified, giving Congress the power to tax incomes "from whatever source derived." That October, Congress passed the Revenue Act of 1913, and Americans met the first Form 1040 — a few pages long, with a top rate that applied to very few families. Two small provisions in that first law have shaped American real estate ever since. The act allowed a taxpayer to deduct **interest** paid on debts and **taxes** paid to state and local governments. When the long amortized mortgage spread after the 1930s, those deductions became a familiar feature of owning a home. You will not be a tax adviser — a licensee must send tax questions to a CPA or tax attorney — but the national exam expects you to know the concepts and do the arithmetic.

How they figured it out. The rules came in layers, each answering a problem. The Revenue Act of 1921 let an owner trade one investment property for another of "like kind" without paying tax on the gain at that moment, because the investment had changed form rather than turned into cash. In 1979, in the *Starker* case, a federal appeals court allowed an exchange in which the replacement property was acquired

after the old one was transferred, and Congress in 1984 fixed the deadlines that govern such **delayed exchanges**: **45 days** to identify the replacement and **180 days** to acquire it. For homeowners, Congress long allowed sellers to postpone gain by buying a more expensive home, plus a once-in-a-lifetime exclusion for sellers 55 and older. The Taxpayer Relief Act of 1997 replaced both with today's simpler rule, **Section 121**: exclude up to **$250,000** of gain (**$500,000** for married couples filing jointly) on a main home owned and used as a residence for **two of the last five years**. And the Tax Reform Act of 1986 and later changes set today's depreciation lives: **27.5 years** for residential rental buildings and **39 years** for nonresidential buildings.

The big idea. Investment math measures what a property earns on the money in it, and every formula is a T-bar from Lesson 10.1. **Net operating income** (Lesson 4.5) is income after operating expenses. Subtract **debt service** (the year's mortgage payments) and you have **cash flow**. Divide cash flow by the **cash invested** — down payment plus acquisition costs — and you have the **cash-on-cash return.** Divide NOI by value and you have the **capitalization rate**; turned around, **value = NOI ÷ cap rate**, the IRV formula. A simple **return on investment** is gain divided by the amount invested, and **appreciation** is the percent of change from Lesson 10.1. For small residential rentals, the **gross rent multiplier** is price ÷ gross *monthly* rent; for commercial property, a gross income multiplier uses *annual* income. Example: a building with NOI of $54,000 valued at a 7.5% cap rate is worth $54,000 ÷ 0.075 = $720,000; if it rents for $6,000 a month, its GRM is $720,000 ÷ $6,000 = 120. These figures describe a property; they do not decide whether anyone should buy it.

Depreciation for tax purposes (also called **cost recovery**) is not a loss in market value; it is a deduction that lets the owner of a building used in business or held for investment recover its cost over a statutory life. Three rules carry the exam. First, **land is never depreciated**, so the land value must be subtracted from the purchase price first. Second, the lives are fixed: **27.5 years** for residential rental buildings and **39 years** for nonresidential buildings, using the **straight-line** method — the same deduction every full year. Third, a **personal residence is not depreciable**; only property used in a business or held to produce income qualifies. Example: a duplex bought for $400,000, of which $80,000 is land, has a depreciable building basis of $320,000 and an annual deduction of $320,000 ÷ 27.5 = $11,636.36. Depreciation reduces taxable income each year without any cash leaving the owner's pocket — but it also lowers the property's basis, so it comes back into the calculation when the

property is sold. (The tax code treats the part of a gain due to depreciation in its own way; that detail belongs to the owner's tax professional.)

Gain is figured in three steps. **Basis** starts as the purchase price plus certain acquisition costs. **Adjusted basis** = basis + capital improvements (a new roof, an addition — not ordinary repairs) − depreciation taken. **Amount realized** = sale price − selling expenses (commission, the seller's closing costs). **Capital gain** = amount realized − adjusted basis. In the duplex example, after six full years of depreciation ($69,818.18) and a $20,000 improvement, adjusted basis is $400,000 + $20,000 − $69,818.18 = $350,181.82. Sold for $520,000 with $31,200 of selling costs, the amount realized is $488,800 and the gain is $138,618.18. A gain on property held **more than one year** is **long-term**; one year or less is **short-term**; the two are generally taxed differently, at rates Congress changes over time, so the exam asks the concept, not the rate. Back to your warm-up: the house bought for $300,000 with a $40,000 kitchen and sold for $400,000 has an adjusted basis of $340,000 — a gain of $60,000 before selling costs, not $100,000.

Homeowners and investors each have a signature rule. The homeowner's is **Section 121**: up to $250,000 of gain on a main home is excluded from income ($500,000 for a married couple filing jointly) if the owner owned the home and used it as a principal residence for at least **two of the five years** before the sale; the exclusion generally may be used once every two years. A homeowner who itemizes may generally deduct **mortgage interest** and **property taxes**, within limits that change. The investor's is **Section 1031**: real property held for **investment or business use** may be exchanged for like-kind real property (an apartment building for raw land qualifies) with the gain **deferred**, not forgiven. A personal residence and property held for resale do not qualify. A **qualified intermediary** holds the proceeds. The investor must **identify** replacement property within **45 days** and **acquire** it within **180 days**. Any **boot** — cash or other non-like-kind property, including relief from debt — is taxable up to the gain, and the deferred gain carries into the new property's basis. In an **installment sale**, where the seller receives payments over time, gain is generally reported as payments are received, in proportion to the gross profit.

On the exam today. Expect a cap-rate or value question, a GRM, perhaps a cash-on-cash return, a depreciation calculation and at least one tax concept. The traps: **depreciating the land** (never); using **27.5 years for a store** (nonresidential is 39); **depreciating a personal home** (not allowed); forgetting to add **improvements** and

subtract **depreciation** in adjusted basis; computing gain from the **sale price** instead of the **amount realized**; subtracting **debt service** to find NOI (it comes out only for cash flow); using annual rent in a residential **GRM**. Know the numbers that are fixed in the statute: $250,000 / $500,000, two of five years, 45 days, 180 days, 27.5 and 39 years, "more than one year" for long-term. And know the professional line: a licensee explains these concepts generally and refers every client's actual tax question to a CPA or tax attorney — on the job, the right answer to "Will I owe tax?" is "Let's get you to a tax professional."

PICTURE STUDY



The Calling of Saint Matthew, Hendrick ter Brugghen, 1621 · Oil on canvas · Centraal Museum, Utrecht

Image: Wikimedia Commons, public domain

Hendrick ter Brugghen of Utrecht had studied in Rome, where he saw how Caravaggio painted the Gospel as if it were happening in an ordinary room, lit by a single window. Here he paints Matthew the tax collector at his counting table at the moment Christ calls him: coins on the table, the tax roll and the inkwell ready, a spectacled colleague still counting — and Matthew pointing to himself as if to ask, "Me?" It opens the lesson on investment and taxes because it shows a man whose business was money and taxation, called to weigh his whole life by a different measure.

Look closely

- Find the coins, the papers and the inkwell on the table. This is a working tax office; the records matter as much as the money.
- Follow the two pointing hands: the one at the left and Matthew's own, pointing at his chest. The painting is a question and an answer.
- Look at the old man in spectacles. He is still focused on the coins — what does that tell you about him?
- Notice the light falling from the upper left across the faces. Ter Brugghen uses it the way Caravaggio did, to show who is seeing and who is not.

Talk about it

1. Tax collectors in Matthew’s day were often resented for collecting more than was owed. Why is honest, exact tax arithmetic part of a professional’s integrity today?
2. Which figure in the painting would make the best bookkeeper, and which the worst? Defend your answer from what you see.
3. Matthew 22:21 says to render unto Caesar what is Caesar’s and unto God what is God’s. How can a family pay its taxes honestly while also using lawful rules, like the home-sale exclusion, without guilt?

PROJECT

The Investment Analysis Worksheet

You will analyze a pretend four-unit rental building the way the exam and an honest investor would: income approach value, GRM, cash flow, cash-on-cash return, annual depreciation, and the tax picture of a pretend sale ten years later — including how a 1031 exchange would change it. The worksheet goes into your Pathway File with a plain statement at the top that it is an educational exercise, not tax or investment advice.

You will need

- Free spreadsheet software
- A basic calculator
- IRS Publication 523 (Selling Your Home) and the IRS like-kind exchange page from this unit's resource list
- Your Lesson 4.5 and 9.5 notes

Steps

1. Inputs (pretend): price $640,000 with $140,000 land value; rent $1,450 per unit per month; 5% vacancy; operating expenses $24,000; a down payment of 25% plus $12,000 of acquisition costs; annual debt service $33,600.
2. Compute PGI, EGI and NOI; then value at a 6.5% cap rate (in this example) and the GRM at the purchase price.
3. Compute annual cash flow and cash-on-cash return. Write one sentence on what the cash-on-cash figure measures that the cap rate does not.
4. Compute annual depreciation on the building at 27.5 years, and the total after ten full years.
5. Pretend sale in year ten: price $860,000, selling costs 6%, and $25,000 of improvements made along the way. Compute adjusted basis, amount realized and gain, and label it long-term.
6. Write a short paragraph on how a Section 1031 exchange into a $1,000,000 replacement property would change the timing of tax on that gain, using the words identify, 45 days, 180 days, qualified intermediary, boot and deferred.

7. Title the sheet “Investment Analysis — Educational Exercise, Not Tax Advice,” date it and file it.

EXAM NOTEBOOK

1. Flashcards for the fixed statutory numbers: $250,000 / $500,000; two of five years; 27.5 years; 39 years; 45 days; 180 days; more than one year = long-term.
2. Draw the gain ladder: purchase price + improvements − depreciation = adjusted basis; sale price − selling costs = amount realized; amount realized − adjusted basis = gain.
3. Trap list titled “The taxman’s traps”: land never depreciates; homes are not depreciated; 39 years for a store; gain uses amount realized; 1031 defers, it does not forgive; boot is taxable.

KEY FORMULAS

$$\text{Cash flow} = \text{NOI} - \text{Debt service} \qquad \text{Cash-on-cash} = \frac{\text{Annual cash flow}}{\text{Cash invested}}$$

$$\text{Cap rate} = \frac{\text{NOI}}{\text{Value}} \qquad \text{Value} = \frac{\text{NOI}}{\text{Cap rate}}$$

$$\text{GRM} = \frac{\text{Sale price}}{\text{Gross monthly rent}} \qquad \text{Value} = \text{GRM} \times \text{Monthly rent}$$

$$\text{Annual depreciation} = \frac{\text{Building cost (not land)}}{\text{27.5 (residential) or 39 (nonresidential)}}$$

$$\text{Adjusted basis} = \text{Basis} + \text{Capital improvements} - \text{Depreciation taken}$$

$$\text{Amount realized} = \text{Sale price} - \text{Selling expenses} \qquad \text{Gain} = \text{Amount realized} - \text{Adjusted basis}$$

$$\text{Taxable home-sale gain} = \text{Gain} - (\$250{,}000 \text{ or } \$500{,}000), \text{ not less than } 0$$

From history. The Sixteenth Amendment was needed because of an 1895 Supreme Court decision, *Pollock v. Farmers’ Loan & Trust Co.*, which held that a federal tax on income from property, such as rents, was a “direct tax” that the Constitution required to be apportioned among the states by population — impossible in practice. Congress proposed the amendment in 1909, and it took nearly four years to win ratification by three-quarters of the states. Rents, interest and the profit on land were at the very center of the dispute from the beginning.

WORKED EXAMPLES

Example 1. A small apartment building produces NOI of $54,000 a year. Comparable sales indicate a 7.5% cap rate (in this example). Its gross rent is $6,000 a month. Find its value by the income approach and its gross rent multiplier.

Show solution

1. Value = NOI ÷ cap rate: $\$54{,}000 \div 0.075 = \$720{,}000$.
2. GRM = price ÷ gross monthly rent: $\$720{,}000 \div \$6{,}000 = 120$.
3. Estimate check: 7.5% of $720,000 is $54,000 — the formula reverses cleanly.
4. Remember the direction: a higher cap rate on the same NOI gives a lower value.

Answer: Value $720,000; GRM 120.

Example 2. An investor bought a duplex for $400,000, of which $80,000 was land value. She rented it for six full years, added a $20,000 roof, and sold it for $520,000, paying $31,200 in commission and selling costs. Find the annual depreciation, adjusted basis and gain.

Show solution

1. Depreciable basis excludes land: $\$400{,}000 - \$80{,}000 = \$320{,}000$; annual depreciation $= \$320{,}000 \div 27.5 = \$11{,}636.36$.
2. Six years: $6 \times \$320{,}000 \div 27.5 = \$69{,}818.18$.
3. Adjusted basis: $\$400{,}000 + \$20{,}000 - \$69{,}818.18 = \$350{,}181.82$.
4. Amount realized: $\$520{,}000 - \$31{,}200 = \$488{,}800$; gain $= \$488{,}800 - \$350{,}181.82 = \$138{,}618.18$ — long-term, since she held it more than one year.

Answer: Depreciation $11,636.36 a year; adjusted basis $350,181.82; long-term gain $138,618.18. (How it is taxed is a question for her tax professional.)

Example 3. A married couple filing jointly bought their home for $310,000, added $40,000 of improvements, and lived in it for eight years. They sell for $905,000 with $45,000 of selling costs. How much gain is taxable under Section 121?

Show solution

1. Two-of-five test: owned and lived in it eight years — they qualify for up to $500,000.
2. Adjusted basis: $\$310{,}000 + \$40{,}000 = \$350{,}000$ (a personal home takes no depreciation).
3. Amount realized: $\$905{,}000 - \$45{,}000 = \$860{,}000$; gain $= \$860{,}000 - \$350{,}000 = \$510{,}000$.
4. Taxable: $\$510{,}000 - \$500{,}000 = \$10{,}000$.

Answer: $10,000 of the $510,000 gain is taxable; $500,000 is excluded.

PRACTICE

1. Easy A residential rental building (not counting land) cost $275,000. What is its annual straight-line depreciation?

   Show answer

   $\$275{,}000 \div 27.5 = \$10{,}000$ a year.

2. Easy State the Section 121 exclusion amounts and the ownership-and-use test.

   Show answer

   Up to $250,000 of gain ($500,000 for married couples filing jointly) on a main home owned and used as a principal residence for at least two of the five years before the sale.

3. Easy In a delayed Section 1031 exchange, how many days does the investor have to identify the replacement property, and to acquire it?

   Show answer

   45 days to identify and 180 days to acquire, both counted from the transfer of the property given up.

4. **Medium** A property with NOI of \$42,000 sells for \$600,000. What is the cap rate?

   Show answer

   $\$42{,}000 \div \$600{,}000 = 0.07 = 7\%$.

5. **Medium** What is a property worth if its NOI is \$63,000 and the market cap rate is 9%?

   Show answer

   $\$63{,}000 \div 0.09 = \$700{,}000$.

6. **Medium** A house that rents for \$3,000 a month sold for \$360,000. Using that GRM, estimate the value of a similar house renting for \$2,800.

   Show answer

   GRM $= \$360{,}000 \div \$3{,}000 = 120$; value $\approx 120 \times \$2{,}800 = \$336{,}000$.

7. **Medium** An investor puts \$135,000 of cash into a property with NOI of \$36,000 and annual debt service of \$25,200. What are the cash flow and cash-on-cash return?

   Show answer

   Cash flow $= \$36{,}000 - \$25{,}200 = \$10{,}800$; cash-on-cash $= \$10{,}800 \div \$135{,}000 = 8\%$.

8. **Hard** A retail building cost \$1,900,000, including \$340,000 of land value. What is the annual straight-line depreciation?

   Show answer

   Building only: $\$1{,}900{,}000 - \$340{,}000 = \$1{,}560{,}000$; nonresidential, 39 years: $\$1{,}560{,}000 \div 39 = \$40{,}000$.

9. **Hard** A single homeowner bought for \$210,000, added \$35,000 of improvements, lived there six years, and sold for \$480,000 with \$28,800 of selling costs. Find the gain and the taxable portion.

   Show answer

   Adjusted basis $= \$245{,}000$; amount realized $= \$451{,}200$; gain $= \$206{,}200$. It is under the \$250,000 exclusion and she meets the two-of-five test, so the taxable portion is \$0.

10. Hard In a 1031 exchange, an investor has a realized gain of $180,000 and receives $40,000 in cash along with the replacement property. How much gain is recognized now, and how much deferred?

Show answer

The $40,000 of cash boot is taxable now (it is less than the gain); the remaining $140,000 is deferred and carries into the replacement property's basis.

11. Challenge An owner paid $250,000 cash for land and sold it five years later for $325,000 (ignore costs). What is the total percent of appreciation and the average simple annual rate?

Show answer

Total: $(\$325{,}000 - \$250{,}000) \div \$250{,}000 = 30\%$. Average simple annual: $30\% \div 5 = 6\%$ a year (a compounded rate would be a little lower).

12. Challenge A seller sells land for $500,000 on an installment basis; her adjusted basis is $300,000. In the first year she receives $100,000 of principal. How much gain does she generally report that year?

Show answer

Gross profit $= \$200{,}000$, so the gross profit percentage is $\$200{,}000 \div \$500{,}000 = 40\%$. Gain reported $= \$100{,}000 \times 0.40 = \$40{,}000$.

COMMON MISTAKES

- Depreciating the land — only the building (improvements) is depreciated.
- Using 27.5 years for commercial property — nonresidential real property uses 39 years.
- Claiming depreciation on a personal residence — only business or investment property qualifies.
- Computing gain from the sale price instead of the amount realized, or forgetting to add improvements and subtract depreciation in adjusted basis.
- Saying a 1031 exchange eliminates tax — it defers it, and boot is taxable now.
- Giving a client tax advice — explain concepts generally and refer actual tax questions to a CPA or tax attorney.

Make it a game · The Taxman's Ten. Write ten statutory numbers on cards — 27.5, 39, 45, 180, $250,000, $500,000, 2 of 5, 1 year, 0 (years to depreciate land), 640 (a bonus from Lesson 10.1). Shuffle and lay them face up. The caller reads a clue ("days to identify a replacement," "life of a store," "married exclusion," "how long land depreciates"); the first player to slap the right card keeps it. Then the caller reads a quick calculation ("$330,000 building ÷ 27.5") and the first correct answer earns a bonus card. Most cards after ten minutes wins.

Scripture. "They say unto him, Caesar's. Then saith he unto them, Render therefore unto Caesar the things which are Caesar's; and unto God the things that are God's." (Matthew 22:21, KJV)

Asked a trap question about taxes, Jesus affirmed the duty to pay what is lawfully owed while placing a higher claim over the whole of life. A family or investor who pays honestly, keeps exact records and uses only the rules the law plainly offers is rendering to Caesar rightly — and the licensee who refers tax questions to a professional instead of guessing is helping them do it.

10.4 The State Portion: License Law in the Northwest and Beyond

OBJECTIVES

- List the subjects a state portion of the licensing exam commonly tests, from the commission's powers to recovery funds.
- Explain why license laws exist, using California's first license law (1917–1919) as the example.
- State the verified, as-of-2026 entry requirements for Washington, Oregon, Idaho, Montana and Alaska, naming each state's licensing agency.
- Apply a state's time limits — education, exam scores and application deadlines — to a candidate's calendar.
- Build a dated state facts sheet for your own state from its official agency website and candidate handbook.

> **Warm-up.** In five minutes, write down every rule you think a state might make about real estate agents — who may be one, what they must learn, what they may never do, and what happens if they break the rules. Then circle the three you think a state cares about most. Keep the list; it is the skeleton of your state facts sheet.

WATCH

Idaho Real Estate License Renewal Requirements

Idaho Real Estate Commission · 4:10

https://www.youtube.com/watch?v=J9gpNm-dpr4

> **WHEN TO WATCH**
> Watch after core idea five; it is a state commission explaining its own renewal and post-license rules, so copy its flowchart into your notebook as a model of what to find for your own state.

BACKUP VIDEO

Look up License and Business Numbers

Oregon Real Estate Agency · 1:50

https://www.youtube.com/watch?v=_A2HWL-glDc

A short official demonstration of the public license lookup; watch it, then find your own state's lookup tool and add its web address to your facts sheet.

KEY TERMS

license law

A state's statute and rules governing who must be licensed to perform real estate activities, how licenses are earned and kept, and how licensees are disciplined.

real estate commission (agency, board)

The state body that administers the license law: issuing licenses, approving education, making rules, investigating complaints and imposing discipline.

state portion

The part of the licensing exam that tests one state's license law, rules and practices, written to that state's outline.

candidate handbook

The testing vendor's official booklet for a state's exam, giving eligibility, scheduling, identification rules, content outlines, scoring and retake rules.

pre-licensing education

The specific courses a state requires before its licensing exam, counted in clock hours; hours count only from courses the state's licensing agency has approved, taken from an approved school, completed in full with the course exam passed, and finished within the state's time window.

post-licensing education

Additional coursework some states require of new licensees within a set period or by their first renewal.

continuing education (CE)

Coursework required to renew a license, often including mandatory topics such as law updates and fair housing.

supervising broker

The broker under whom a new licensee must work; states call this person the managing, principal, designated, employing or supervising broker.

recovery (guaranty) fund

A state fund, maintained in some states, that compensates consumers who win uncollectible judgments against licensees for certain misconduct.

license suspension and revocation

Disciplinary actions that temporarily (suspension) or permanently (revocation) end the right to practice, imposed after notice and an opportunity for a hearing.

errors and omissions (E&O) requirement

A state rule requiring licensees to carry professional liability insurance, as Idaho, Montana and Alaska do for active licensees.

CORE IDEAS

The story. Before 1917, anyone in America could call himself a real estate agent, with no test, no course and no one to complain to. On June 1, 1917, California's governor signed the nation's first real estate license law, and some 8,000 people and firms were licensed under it — until a court struck the law down. The legislature tried again with the Real Estate Act of 1919, and on November 29, 1919, the California Supreme Court upheld it as a reasonable exercise of the state's power to regulate for the

common good. Licenses under the new act began in January 1920, and by that April about 15,000 brokers and salespeople held them, according to the state's own real estate department. Other states copied the model, and today every state, the District of Columbia and the territories license real estate practitioners. That is why your exam has two parts. The national portion, which this course has taught, covers what every state shares. The **state portion** tests the license law of the state that will issue your license.

How they figured it out. The reasoning in 1919 is the reasoning now: a real estate agent handles other people's largest asset and other people's money, and the public cannot easily judge an agent's competence or honesty in advance. So the state sets a floor — a minimum age, required education, an examination, a background check — and keeps a body to enforce it, usually called a **real estate commission** (or agency, board or department). The commission's powers are what the state portion tests first: it adopts rules, approves schools and courses, issues and renews licenses, investigates complaints, holds hearings and imposes discipline — reprimands, fines, required education, **suspension** or **revocation** — always after notice and an opportunity to be heard, with appeal to the courts. Some states also maintain a **recovery fund** to compensate consumers who win judgments against licensees for certain misconduct but cannot collect them. Each state built its own system, so the details differ.

The big idea. State portions follow a common outline even though the answers differ. Expect questions on: (1) the **commission** and its powers; (2) **activities requiring a license** — typically listing, selling, buying, exchanging, renting or negotiating real property for others for compensation — and the **exemptions** (commonly owners dealing with their own property, attorneys in the course of legal practice, court-appointed fiduciaries and some resident managers); (3) **license categories** and how one advances from the entry license to a broker's license; (4) **education** — pre-licensing, post-licensing and continuing education — and renewal periods; (5) **advertising** rules; (6) **trust account** rules — deposit deadlines, record keeping, reconciliation; (7) **agency relationships and disclosure**, including state-required pamphlets and forms; (8) state-specific contracts and **disclosures**; and (9) **discipline**, penalties and any recovery fund. **What counts as an hour.** In every Northwest state, an hour counts toward the pre-licensing requirement only when four things are all true: the course is **approved** (certified) for pre-license credit by

that state's licensing agency and taken from an approved school or provider; it is one of the **specific required courses**, not just any real estate class; you **complete the whole course** — its full clock hours of instruction, in a classroom, by live video or self-paced online where the state allows — and **pass its course final exam**; and it falls inside the state's **time window**. This School Launch course, high-school classes, college classes that are not on the state's approved list, continuing-education courses, books and videos do not count, and you cannot test out of the hours. Your study tools are official and free: the commission's website, the statute and rules, and the testing vendor's **candidate handbook** with the state content outline.

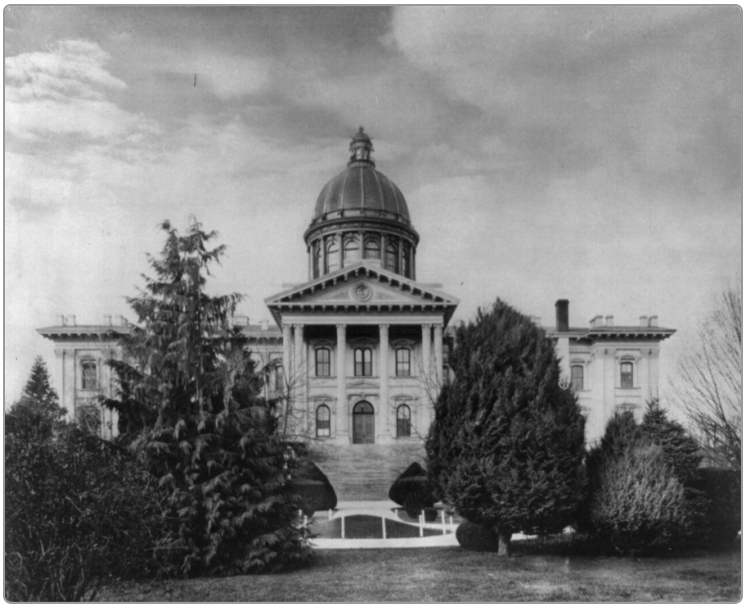
Here is what the Northwest states' own agencies say, as of 2026 (checked October 2026; confirm before you rely on any of it). **Washington** — the **Department of Licensing** calls the entry license **broker**. Its broker-license page requires an applicant to be at least 18 with a high school diploma or equivalent, to complete 90 hours of approved education (a 60-hour Real Estate Fundamentals course and a 30-hour Real Estate Practices course, both from a DOL-approved school and each ending in a course final exam), to apply for and complete the exams within two years of finishing those courses, and to pass both the state and national exams, given by PSI, within six months of each other or retake both. Fingerprints follow the exam, the application is due within one year of passing, and a broker works for a firm under a managing broker's supervision. The first two-year renewal requires 90 hours of continuing education, including 30-hour Advanced Practices and Real Estate Law courses. **Oregon** — the **Oregon Real Estate Agency** also calls the entry license **broker**: age 18, a high school diploma, GED or equivalent, 150 hours of pre-license education in seven specific courses (Real Estate Law, Oregon Real Estate Practice and Real Estate Finance, 30 hours each; Contracts and Agency Law, 15 each; Property Management, 10; Real Estate Brokerage, 20) from an Agency-approved private career school or an in-state community college, college or university — with at least 75% on each course's final exam at a private school, or a grade of C or better at a college, and only courses completed on or after January 1, 2013 counting — and passing both sections of the PSI exam, with 75% needed on each portion. Fingerprinting is done at a PSI test center; exam scores and background clearance are each good for one year; and the new broker must associate with a managing principal broker. The first active renewal requires the Broker Advanced Practices course.

Idaho — the **Idaho Real Estate Commission**, whose licensing now runs through the state's Division of Occupational and Professional Licenses, issues a **salesperson** license: age 18, 90 hours of pre-licensing education in two 45-hour Commission-certified modules (Module 1 on fundamental concepts, Module 2 on listing, selling, buying and closing), taken in a classroom, by remote video or self-paced online, with 100% attendance and at least 70% on each module's course exam — passing the exam without completing the course earns no credit — and completed within three years before the application, the exam through Pearson VUE, fingerprints, and licensure under a designated broker. Licenses renew every two years with two Idaho core courses plus elective hours; the first active renewal requires the core courses plus post-license education, including an 8-hour Post License Fundamentals course, and an active licensee must carry errors-and-omissions insurance. **Montana** — the **Board of Realty Regulation** issues a **salesperson** license. Its salesperson checklist (updated November 2025) requires age 18, credit for two years of high school or the equivalent, 70 hours of Board-approved pre-licensing education completed within the 24 months before applying and shown by a completion certificate, a passing score on the state and national portions of the Montana exam within the past 12 months (registration through Pearson VUE), employment by or contract with a broker holding a supervising broker endorsement, and proof of professional liability (E&O) insurance; licensees complete 12 hours of continuing education each year.

Alaska — the **Alaska Real Estate Commission** issues a **salesperson** license with the highest minimum age in the region, **19.** Its application instructions require 40 hours of pre-licensing education from a Commission-approved course, shown by a completion certificate valid for 18 months, a passing score on the Alaska exam through Pearson VUE (scores are valid six months, and the complete application must be filed before they expire), proof of errors-and-omissions insurance, and an employing broker's signed information; the application fees include a recovery fund fee. Every new licensee must complete 30 hours of **post-licensing education** within one year of initial licensure or the license lapses — in addition to the continuing education required for renewal — and licenses expire on January 31 of even-numbered years. The pattern across all five: an adult age floor, required education, a two-part exam, a background check and a supervising broker. Notice too how differently the numbers fall — 40 hours to 150 — which is exactly why the national exam never asks them and the state exam always does.

On the exam today. The state portion is shorter than the national portion but no easier, because its answers cannot be reasoned out — they must be known. Questions are drawn from the state's published outline in the candidate handbook, and they reward exact numbers: hours, deadlines, renewal periods, how quickly trust money must be deposited, how long records must be kept, what a disclosure pamphlet must say and when it must be delivered. Three study habits work. First, **use only official sources:** the commission's site, the statute and rules, and the vendor's handbook — never a forum post or a video's numbers without checking. Second, **build a facts sheet** organized by the nine common topics and date every entry. Third, **drill the numbers** with flashcards, because the state portion loves to offer four plausible numbers. If you later move, you will repeat this work for the new state, which may let licensees from other states skip the national portion.

PICTURE STUDY



The Oregon State Capitol, Salem, Benjamin A. Gifford, 1909 · Photograph · Library of Congress, Prints and Photographs Division, Washington, D.C.

Image: Wikimedia Commons, public domain

Benjamin A. Gifford was a photographer of the Pacific Northwest who spent decades photographing Oregon's landscapes and towns. In 1909 he photographed the state capitol in Salem, completed in the 1870s and destroyed by fire in 1935. It opens the lesson on the state portion because the state house is where license laws are made: the national exam teaches what every state shares, but the legislature and the commission in each capital decide who may practice real estate within its borders, what they must learn and what happens when they break faith with the public.

Look closely

- Look at the columns and the steps leading up to the doors. Public buildings were designed to say that the law is open to every citizen and above every one.
- Find the dome. Capitols across the country borrowed the shape from the national Capitol — the states copying a common model, as their license laws later did.
- Notice the Douglas firs and evergreens. This is unmistakably a Northwest capitol, set among the trees of the Willamette Valley.

- Remember that this building is gone. Laws, like buildings, are replaced and revised — which is why every state fact you learn must be dated and rechecked.

Talk about it

1. Which of the nine state-portion topics do you think matters most to protecting the public, and why?
2. Why does a state require licensees to work under a supervising broker at first, rather than letting a newly licensed agent practice alone?
3. Proverbs 18:15 says the prudent heart gets knowledge and the wise ear seeks it. How does a licensee keep “seeking” knowledge after passing the exam, and why does the law require it?

PROJECT

My State Facts Sheet

You will build the study tool every successful candidate makes: a dated, sourced, one-to-two-page facts sheet for your own state's license law, organized by the nine topics state portions test. If you live in Washington, Oregon, Idaho, Montana or Alaska, start from this lesson and confirm every fact on the agency's site; if you live elsewhere, start from your own commission's site. The facts sheet joins your Pathway File and will be your main study sheet for the state portion.

You will need

- Your state real estate commission's website (search "[your state] real estate commission license requirements")
- The testing vendor's candidate handbook for your state (linked from the commission's site)
- Your exam notebook and index cards
- A highlighter

Steps

1. Find your state's licensing agency and write its exact name, website and the title of the entry-level license at the top of the page.
2. Download the candidate handbook. Record the testing vendor, the number of questions and time for each portion, the passing score, the identification rules and the retake rules exactly as the handbook states them.
3. Fill in the nine topics from core idea three — commission powers, activities and exemptions, license categories, education and renewal, advertising, trust accounts, agency disclosure, state forms and disclosures, discipline and recovery fund — with at least one sourced fact under each.
4. List every time limit you find (education validity, exam score validity, application deadline, post-licensing deadline, renewal period) on a single timeline, as in the worked examples.
5. Return to the Lesson 9.1 desk reference and fill in "My state adds:" with your state's protected classes beyond the federal seven, as your state's law lists

them.

6. Make index cards for every number on the sheet.
7. Write the date you checked each source beside it, title the page “My State Facts Sheet,” and file it.

EXAM NOTEBOOK

1. Make a five-column table — WA, OR, ID, MT, AK — with rows for agency, license title, minimum age, hours and testing vendor, filled in from this lesson and dated.
2. Draw a timeline for your own state: education complete → exam → background check → application → licensed → post-licensing deadline → first renewal, with each time limit marked.
3. Trap list titled “State numbers are not national numbers”: never answer a national question with a state rule; never trust a number without its date and source; Alaska’s age is 19; Oregon’s passing line is 75% on each portion.

> **From history.** On April 25, 1935, fire destroyed the Oregon capitol in this photograph. The state replaced it with a new capitol, dedicated in 1938, faced in white marble and crowned by a gilded bronze statue of a pioneer. The laws made inside it — including the one that licenses Oregon’s brokers today — are revised session by session, which is the plain reason this course dates every state fact and sends you to the agency’s own website before you rely on any of them.

Example 1. A Washington candidate passes the state portion of the broker exam on March 1. By what date must she pass the national portion, and what deadline follows once both are passed?

Show solution

1. Find the rule on the Department of Licensing's page: both exams must be passed within six months of each other, or both must be retaken.
2. Count six months from March 1: September 1.
3. Next rule: the license application must be filed within one year of passing the final exam.
4. If she passes the national portion on, say, May 15, her application deadline is the following May 15 — and fingerprints come after the exam.

Answer: She must pass the national portion by September 1; then she has one year from her final passing date to apply.

Example 2. An Alaska candidate turns 19 in January 2027, completes 40 hours of pre-licensing education on March 1, 2027, passes the exam on April 10, 2027, and is licensed on May 20, 2027. Using the Commission's instructions, list her deadlines.

Show solution

1. Education certificates are valid 18 months from completion: the education is good until September 1, 2028.
2. Exam scores are valid six months: the complete application must be on file before October 10, 2027.
3. Post-licensing education: 30 hours within one year of initial licensure — by May 20, 2028 — with the affidavit and certificates filed within 30 days after that year.
4. Renewal: licenses expire January 31 of even-numbered years, so her first expiration is January 31, 2028 (licenses issued within 90 days of expiration run through the next biennium; hers is more than 90 days earlier).

Answer: Application before October 10, 2027; 30 hours of post-licensing education by May 20, 2028; first renewal by January 31, 2028. Always confirm each date with the Commission.

Example 3. Two Montana applicants file on June 1, 2027. Ana finished her 70 hours in March 2025 and passed the exam in May 2027. Ben finished his 70 hours in January 2027 and passed the exam in April 2026. Using the Board's checklist, who is eligible?

Show solution

1. Rule 1: 70 hours completed within the past 24 months. Ana's March 2025 course is more than 24 months before June 1, 2027 — too old. Ben's January 2027 course is fine.
2. Rule 2: exam passed within the past 12 months. Ana's May 2027 pass is fine; Ben's April 2026 pass is more than 12 months old.
3. Neither meets both time limits as of June 1, 2027.
4. Remedy: Ana must retake the education; Ben must retake the exam. Both also need a supervising broker and E&O insurance.

Answer: Neither is eligible on June 1, 2027 — Ana's education is stale and Ben's exam score is stale. Time limits are a favorite state-portion question.

PRACTICE

1. Easy Name the licensing agency and the entry-level license title in Washington and in Oregon.

   Show answer

   Washington: the Department of Licensing, "broker." Oregon: the Oregon Real Estate Agency, "broker."

2. Easy Which of the five Northwest states requires its applicants to be 19, and how many pre-licensing hours does it require?

   Show answer

   Alaska — age 19 and 40 hours of pre-licensing education (as of 2026).

3. Easy What is a candidate handbook, and where do you find it?

   Show answer

   The testing vendor's official booklet for a state's exam — eligibility, scheduling, ID rules, content outline, scoring and retakes. It is linked from the state commission's or the vendor's website.

4. Medium List six topics a state portion commonly tests.

Show answer

Any six of: the commission's powers; activities requiring a license and exemptions; license categories; education, CE and renewal; advertising rules; trust account rules; agency relationships and disclosure; state contracts and disclosures; discipline and recovery funds.

5. Medium Why was California's 1919 license law significant?

Show answer

After the 1917 law was struck down, the 1919 Real Estate Act was upheld by the California Supreme Court as a reasonable exercise of the state's power to regulate for the common good, establishing the model of state real estate licensing that other states followed.

6. Medium According to the Washington Department of Licensing, how many hours of pre-license education are required, in which two courses?

Show answer

90 hours: a 60-hour Real Estate Fundamentals course and a 30-hour Real Estate Practices course.

7. Medium Which Northwest states in this lesson require errors-and-omissions insurance for active licensees, according to their agencies' materials?

Show answer

Idaho, Montana and Alaska. Check Washington's and Oregon's current rules on their agencies' sites before stating anything about them.

8. Hard An Oregon candidate passes both sections of the exam on February 1, 2027, but her background check clears only on March 15, 2028. Can the Agency issue her license?

Show answer

No. The Oregon Real Estate Agency says exam scores and background check clearances are each good for one year and a license can be issued only while both are valid; her scores expired February 1, 2028, so she must retest.

9. Hard An Idaho applicant finished Module 1 in April 2023 and Module 2 in May 2026 and applies in June 2026. Is Module 1 still valid?

Show answer

No. Idaho requires all pre-license courses to be completed within the three years immediately preceding the application date; April 2023 is more than three years before June 2026, so Module 1 must be retaken.

10. Hard Explain the difference between a suspension and a revocation, and name the procedural right every licensee has before either is imposed.

Show answer

A suspension temporarily removes the right to practice; a revocation ends the license. Before either, the licensee is entitled to notice of the charges and an opportunity for a hearing, with appeal to the courts.

11. Challenge A friend says, “I watched a video that said Montana needs 60 hours.” In three sentences, explain how you would check the claim and what you would find as of 2026.

Show answer

I would go to the Montana Board of Realty Regulation’s own salesperson page and its licensing checklist rather than trust the video. The Board’s checklist (updated November 2025) requires 70 hours of approved pre-licensing education completed within the past 24 months. I would date the fact on my sheet and recheck it before applying, since rules change.

12. Challenge Compare the post-licensing requirements of Alaska and Idaho as stated by their agencies.

Show answer

Alaska requires 30 hours of post-licensing education within one year of initial licensure, or the license lapses. Idaho requires, at the first active renewal, two Commission core courses plus post-license education including an 8-hour Post License Fundamentals course.

COMMON MISTAKES

- Answering a national-portion question with a state rule, or a state-portion question with a national pattern.

- Trusting numbers from videos, forums or old books instead of the commission's site and the current candidate handbook.
- Forgetting time limits — education, exam scores and applications all expire, and the state portion tests them.
- Assuming every state calls its entry license "salesperson" — Washington and Oregon call it "broker."
- Assuming the minimum age is 18 everywhere — Alaska requires 19.
- Thinking discipline can be imposed without notice and a hearing — due process applies before suspension or revocation.

Make it a game · Which State?. Write fifteen fact cards from this lesson, each naming one state's rule without naming the state: "entry license called broker, 150 hours," "age 19," "two 45-hour modules," "70 hours within 24 months," "state and national within six months of each other," "75% on each portion," "30 hours of post-licensing within a year." Lay five state cards on the table — WA, OR, ID, MT, AK. The caller reads a fact; the first player to tap the right state keeps the fact card. Two taps on Washington and Oregon for "broker" facts are both right. Most cards in ten minutes wins.

Scripture. "The heart of the prudent getteth knowledge; and the ear of the wise seeketh knowledge." (Proverbs 18:15, KJV)

The proverb pairs getting knowledge with continuing to seek it, and license law requires both: an exam to enter the profession and continuing education to remain in it. A licensee who checks the current rule instead of repeating last year's is practicing a small but real form of prudence.

10.5 Exam Day and the Road to the License

OBJECTIVES

- List, in order, the common steps from pre-licensing education to a first active license, and identify which steps your state handbook governs.
- Describe exam-day procedure — identification, personal items, calculators, timing, flagging and review, scoring and retakes — and where to confirm each rule.
- Apply four-choice test strategy: read the last line first, find the qualifier (EXCEPT, NOT, BEST), eliminate two choices and choose the best remaining answer.
- Compute the number of correct answers needed at a given cut score and plan a pace with checkpoints for a timed exam.
- Build a two-week final review plan, assemble the Pathway File, and sit the course's full-length practice national exam under honest conditions.

> **Warm-up.** In five minutes, write the date you hope to hold a real estate license and work backward: when must you finish a pre-licensing course, when must you schedule the exam, and how old will you be at each step? Then write one sentence on what you want a client to say about you after your first closing.

WATCH

It's the night before your real estate exam! What should you do?

PrepAgent · 5:26

https://www.youtube.com/watch?v=waMtD84q2i8

> **WHEN TO WATCH**
> Watch after core idea four; write his advice as a checklist and compare it with the two-week plan in core idea six, keeping whatever fits you.

BACKUP VIDEO

PSI Test Centers

Real Estate Training Institute · 3:45

https://www.youtube.com/watch?v=WFliTRKVFfY

Watch before writing your handbook card; note each test-center procedure he describes and check it against your own state's handbook, which governs if they differ.

KEY TERMS

scored item

An exam question that counts toward the candidate's score.

pretest (unscored) item

A new question included to gather statistics for future exams; it does not count, and the candidate cannot tell which items they are.

cut score

The minimum score needed to pass, set by the state or recommended by the testing company; commonly 70%, and 75% in Oregon.

content outline

The testing company's published list of topics and their weights for an exam, found in the candidate handbook.

qualifier

A word in a question stem — EXCEPT, NOT, BEST, MOST, FIRST — that changes what the question is asking.

distractor

A wrong answer choice written to look plausible, often the result of a common mistake.

flagging

Marking a question on a computer-based exam to return to it later before submitting.

retake policy

The handbook's rules for re-examination after a failed attempt, including any waiting period, fee and whether only the failed portion must be retaken.

background check

A criminal-history review, usually based on fingerprints, that most states require before issuing a license.

Pathway File

This course's portfolio of projects, facts sheets and practice exams that documents what the student has learned.

CORE IDEAS

The story. On July 2, 1881, a disappointed seeker of a government job shot President James A. Garfield in a Washington railroad station; Garfield died that September. The crime shocked the country into confronting a problem it had tolerated for decades: federal jobs were handed out as political rewards, and every new administration

brought a crowd of office-seekers to the capital. On January 16, 1883, President Chester A. Arthur signed the **Pendleton Civil Service Reform Act**, which created a commission to fill many federal positions by **competitive examination** — the job would go to the person who could show, on a fair test, that he knew the work. Professional licensing grew from the same conviction in the decades that followed: doctors, lawyers, accountants and, from 1917, real estate agents would earn the right to serve the public by demonstrating knowledge, not by knowing the right person. When you sit down at a testing-center computer, you are taking part in that reform. Nobody can hand you the license, and nobody can take your score from you.

How they figured it out. A fair exam has to test what the job actually requires. Testing companies therefore build their content outlines from studies of what new licensees do and need to know, and they weight the topics accordingly — which is why contracts and agency carry the most weight on both national outlines. New questions are tried out as **unscored pretest items** before they ever count: Pearson VUE's 2025 national salesperson outline, for example, has 80 scored items plus 5 unscored pretest items, and PSI's 2023 outline has 80 scored items with a recommended cut score of 70% for salespersons. You cannot tell which items are pretest items, so every question deserves your best effort. Each state then sets its own rules for registration, identification, timing, passing scores and retakes, and publishes them through its testing vendor in the **candidate handbook**. Oregon, for instance, requires 75% on each portion. The handbook is the rulebook; read it twice before exam day, and again the night before.

The big idea. The road to a license runs in a predictable order, though every state adjusts the details. (1) Meet the **age** requirement — 18 in most states, 19 in Alaska. (2) Complete the state-approved **pre-licensing course** and keep its certificate, watching how long it stays valid. (3) Follow the state's order for **application, registration and scheduling** with the testing vendor (PSI or Pearson VUE in the Northwest). (4) Complete the **fingerprints and background check** at the point your state requires — before the exam in some states, after it in others. (5) Sit and pass **both portions** of the exam; where your handbook allows, a candidate who fails one portion retakes only that portion within a set period. (6) File the **license application** before your scores expire. (7) **Join a supervising brokerage** — every state requires a new licensee to work under a supervising, managing, designated, principal or employing broker — and choose it as carefully as you would choose a teacher, because that is what it will

be. (8) Arrange **errors-and-omissions insurance** where required. (9) Complete any **post-licensing education** by its deadline. Write your own state's version of these nine steps from its official sources, with dates.

Exam day itself is a matter of following rules calmly. Arrive early; handbooks commonly ask candidates to arrive well before the appointment, and a late candidate may forfeit the fee. Bring exactly the **identification** the handbook requires — commonly a current government-issued photo ID with a signature, with the name matching your registration exactly. Personal items — phone, watch, notes, bags, often even a hat — go into a locker. Testing vendors commonly permit only a **silent, non-programmable calculator** or provide one on screen; check your handbook rather than assume, and practice with the plainest calculator you own. The exam is given on a computer, with a clock on the screen. You can usually **flag** a question and return to it, and there is **no penalty for guessing**, so never leave a question blank. Score reports are often given at the test center when you finish; the handbook explains what to do next if you pass, and the waiting period, fee and procedure for a **retake** if you do not. Many capable people pass on a second attempt; a failed portion is information, not a verdict.

Four-choice questions reward method. **Read the last line of the stem first**, so you know what you are looking for before you read the story. **Find the qualifier**: EXCEPT and NOT turn the question upside down, so convert it into four true-or-false statements and pick the false one; BEST and MOST mean two choices may be partly right and you want the better one. **Eliminate two** choices you know are wrong, then decide between the last two. Be wary of **absolutes** such as "always," "never," "all" and "only," which are often wrong — but not always, because some law really is absolute (the 1866 Act has *no* exemptions; land is *never* depreciated). Watch for the **distractor built from a common mistake**: the commission computed on the wrong whole, the remedy belonging to the other party, the right term with the wrong date. On math, estimate before you calculate and make sure your answer is among the choices before you move on. Change an answer only for a reason, not a feeling. And keep moving: at about a minute and a half per question, a question that takes four minutes is stealing time from three others.

Plan the last two weeks. **Days 1–10:** one unit a day — reread each lesson's "On the exam today" paragraph and common mistakes, redo every practice question you missed the first time, drill that unit's index cards and retake its unit test. **Day 11:**

math — every formula on your card, every worked example in Unit 10, until you can do them without looking. **Day 12:** your state facts sheet and its numbers. **Day 13:** the course's full-length practice national exam, timed and proctored, then a careful review of every miss. **Day 14:** light review of trap lists only, an early dinner and a full night's sleep. Then the capstone of this course: assemble the **Pathway File** — every project from Units 1 to 10, the formula card and the state facts sheet — and sit the **final exam** as a testing company would give it: 100 questions, two and a half hours, closed book, a basic calculator, no pauses. A student who passes it honestly knows most of the national portion and is ready to make the state's pre-licensing course a review.

On the exam today. Everything in this course has been aimed at a day in a quiet room with a computer and a clock. Prepare for it with method: read the handbook, follow the steps in order, manage your time, eliminate, estimate and never leave a blank. But remember what the license is for. A real estate licensee serves families in one of the largest decisions of their lives — the first home bought with years of savings, the farm sold after a parent's death, the house left behind for a new job across the country. Those families will never see your exam score. They will see whether you know the law, whether you handle their money as a trust, whether you tell them the truth when it costs you a commission and whether you treat every buyer at the door with equal respect. That is the work this course has tried to prepare you for. Pass the exam well, then do the work well. Both are worth doing.

PICTURE STUDY



The Avenue at Middelharnis, Meindert Hobbema, 1689 · Oil on canvas · The National Gallery, London

Image: Wikimedia Commons, public domain

Meindert Hobbema painted this road near the village of Middelharnis, in the Netherlands, in 1689, late in a career that had slowed after he took a steady post in Amsterdam's excise office. It is one of the most famous landscapes in Dutch painting: a plain country avenue, newly planted trees, ditches and fields, and a single traveler walking toward the town. It closes the course because it is a picture of a road that leads somewhere — straight, a little rutted, lined with work still in progress — and that is what the road to a license looks like.

Look closely

- Follow the road from your feet to the church tower. The perspective pulls your eye straight to the destination, as a good plan should.
- Find the man walking with his dog in the middle of the road. He is not running; he is walking steadily, and he will arrive.
- Look at the nursery of young trees at the right, where a man is pruning. Someone is planting for a future he may not see — the long view of every good profession.
- Notice the ruts in the road. Others have traveled this way before; the road is real, worn and passable.

Talk about it

1. If this road were your path to a license, what would the church tower stand for, and what would the ruts be?
2. Hobbema painted the trees as tall and thin as they actually were, newly trimmed. Why might an honest painting of an ordinary road be more moving than an imaginary grand one?
3. Proverbs 22:29 says that a man diligent in his business shall stand before kings. What does diligence in real estate look like on an ordinary Tuesday, long after the exam is over?

PROJECT

The Road-to-License Plan and the Finished Pathway File

This last project has three parts: a dated, personal road-to-license plan for your own state, a two-week final review calendar, and the assembled Pathway File itself — capped by your scored practice final. When it is done, you will hold in one binder the evidence of a year's work and a plan for what comes next.

You will need

- Your state facts sheet from Lesson 10.4 and your state's candidate handbook
- A calendar (paper or digital)
- Every project from Units 1–10, your formula card and your exam notebook
- A binder with ten tab dividers, and a timer for the practice final

Steps

1. Write your state's version of the nine steps from core idea three, each with its source and a realistic target date, starting from the date you will meet the age requirement.
2. From the candidate handbook, copy onto one card: the ID required, arrival time, permitted calculator, number of questions and time for each portion, passing score and retake rules.
3. Fill in the two-week review calendar from core idea six, assigning each day's units, and mark the day for the practice final.
4. Assemble the Pathway File: one tab per unit, each holding that unit's projects in lesson order, with the formula card and state facts sheet at the front.
5. Sit the course final under honest conditions — 100 questions, 150 minutes, closed book, basic calculator, a parent proctoring — and score it as a testing company would.
6. Review every miss and write each one, corrected and explained, in the back of your exam notebook. Record your score by unit on a single page.

7. Write a one-page letter to yourself, to open on the day you receive your license, saying what kind of licensee you intend to be. Seal it in the back of the binder.

EXAM NOTEBOOK

1. Draw the road to the license as a straight road with nine milestones — age, course, scheduling, background check, exam, application, brokerage, E&O, post-licensing — and write your target date beside each.
2. Make a strategy card: last line first; circle the qualifier; eliminate two; estimate math; beware absolutes; never leave a blank; change answers only for a reason.
3. Trap list titled “Exam-day disasters”: the wrong ID; arriving late; a programmable calculator; spending five minutes on one question; leaving blanks; skipping the handbook.

KEY FORMULAS

$$\text{Correct answers needed} = \text{Scored items} \times \text{Cut score}$$

$$\text{Pace} = \frac{\text{Minutes allowed}}{\text{Number of questions}}$$

From history. Competitive examination for public service is older than the United States. Imperial China selected officials by written examination for more than thirteen centuries, until the system was abolished in 1905. British reformers studied the Chinese model, and the Northcote–Trevelyan Report of 1854 recommended that Britain’s civil service be recruited by open examination. American reformers studied the British system in turn, and the Pendleton Act of 1883 brought the idea home — the long ancestry of the computer screen you will face at the testing center.

WORKED EXAMPLES

Example 1. In this example, a national portion has 80 scored items and 5 unscored pretest items. How many correct answers are needed at a 70% cut score, and at a 75% cut score? Why should the candidate still answer all 85 carefully?

Show solution

1. At 70%: $80 \times 0.70 = 56$ correct answers.
2. At 75%: $80 \times 0.75 = 60$ correct answers.
3. The 5 pretest items do not count, but the candidate cannot tell which they are.
4. So every one of the 85 questions must be answered as if it counts — and none left blank, since there is no penalty for guessing.

Answer: 56 correct at 70%; 60 correct at 75%. Treat all 85 questions as scored. (Your state's handbook gives the actual numbers.)

Example 2. The course final has 100 questions in 150 minutes. Plan a pace with checkpoints that leaves 10 minutes at the end to revisit flagged questions.

Show solution

1. Overall pace: $150 \div 100 = 1.5$ minutes per question.
2. Reserve 10 minutes: $140 \div 100 = 1.4$ minutes per question for the first pass.
3. Checkpoints: question 25 by 35 minutes, question 50 by 70 minutes, question 75 by 105 minutes, question 100 by 140 minutes.
4. At each checkpoint, if you are behind, flag the slowest remaining questions and keep moving.

Answer: Work at about 1.4 minutes per question: Q25 at 35 min, Q50 at 70, Q75 at 105, Q100 at 140, leaving 10 minutes for flagged items.

Example 3. Apply the method to this question: “All of the following are fiduciary duties an agent owes a client EXCEPT: A. Obedience B. Confidentiality C. Accounting D. Advertising the property in every available medium.”

Show solution

1. Read the last line first: we want the item that is NOT a fiduciary duty.
2. Convert to true/false: obedience is a fiduciary duty (true); confidentiality (true); accounting (true).
3. Choice D is false — no fiduciary duty requires advertising everywhere; marketing is set by the listing agreement, not by OLD CAR.
4. Check for traps: D uses an absolute (“every available medium”), another sign it is the odd one out.

Answer: D. The EXCEPT question becomes four true-or-false statements; the one false statement is the answer.

PRACTICE

1. Easy Is there a penalty for guessing on the licensing exam, and what does that mean for blank answers?

   Show answer

   No — only correct answers count, so a blank is always wrong. Answer every question, guessing when necessary after eliminating what you can.

2. Easy What is an unscored pretest item, and how should you treat one?

   Show answer

   A new question included to gather data for future exams; it does not count. Since you cannot tell which items they are, treat every question as scored.

3. Easy Where do you find the official rules for ID, calculators, scoring and retakes for your state’s exam?

   Show answer

   In the testing vendor’s candidate handbook for your state, linked from the state commission’s website.

4. **Medium** A portion has 80 scored items and requires 75% to pass. How many correct answers are needed? How many can be missed?

Show answer

$80 \times 0.75 = 60$ correct; up to 20 may be missed.

5. **Medium** Put these steps in a common order: join a supervising brokerage; complete the pre-licensing course; pass the exam; file the license application; complete post-licensing education.

Show answer

Complete the course, pass the exam, file the application (with the background check as your state requires), join a supervising brokerage, and complete post-licensing education by its deadline. Some states require the brokerage's signature on the application itself.

6. **Medium** Explain how to approach a question with NOT or EXCEPT in the stem.

Show answer

Turn it into four true-or-false statements about the topic; three will be true and one false, and the false one is the answer. Circle the qualifier so you do not answer the opposite question.

7. **Medium** A 100-question exam allows 150 minutes. You reach question 50 at the 90-minute mark. What should you do?

Show answer

You are 15 minutes behind the 75-minute pace for question 50. Speed up: flag any question you cannot answer within about a minute and a half, guess on it, and return only if time remains.

8. **Hard** Why are absolute words like "always" and "never" often wrong in answer choices, and give one real estate rule where the absolute is right.

Show answer

Most rules have exceptions, so a choice claiming no exceptions is usually too broad. But some rules are absolute — for example, land is never depreciated, or the Civil Rights Act of 1866 has no exemptions — so know the law rather than rely only on the word.

9. Hard A candidate passes the national portion but fails the state portion. What does she do next, and where does she find the rules?

Show answer

She follows her state's retake rules in the candidate handbook — commonly she may retake only the failed state portion, within a set period and after paying the fee, before her passing national score expires. She should study the state facts sheet topic by topic using the score report's weak areas.

10. Hard A question asks for the BEST answer, and two choices seem correct. How do you decide?

Show answer

Reread the stem for the exact situation and the qualifier, then choose the answer that is complete and most directly responsive — often the one that states the rule precisely rather than partially, or the one that protects the client and complies with law. Eliminate the choice that is true in general but does not answer this question.

11. Challenge Write a two-week review plan in five lines for a student who scored 58% on the Unit 7 test and 85% or better on every other unit.

Show answer

Days 1–4: Contracts (Unit 7) — reread every lesson's exam paragraph and common mistakes, redo every missed practice item, retake the unit test. Days 5–10: one or two other units a day, with Unit 8 paired to Unit 7 since agency and contracts are the heaviest topics. Day 11: math. Day 12: state facts. Day 13: full timed practice final and review; Day 14: trap lists only, then rest.

12. Challenge In three sentences, explain what a family needs from a licensee that no exam score can show.

Show answer

A family needs honesty when the truth costs the licensee a commission, care with their money and their deadlines, and equal respect for every buyer and seller. They need someone who knows the limits of their own knowledge and sends them to an attorney, inspector or tax professional when needed. The exam proves knowledge; only years of faithful work prove character.

COMMON MISTAKES

- Skipping the candidate handbook and arriving with the wrong ID, the wrong calculator or too late to be admitted.
- Leaving questions blank — there is no penalty for guessing.
- Answering the opposite of an EXCEPT or NOT question because the qualifier was missed.
- Spending several minutes on one hard question instead of flagging it and returning later.
- Assuming national and state portions must both be retaken after failing one — check the handbook; often only the failed portion is retaken within a set time.
- Choosing a first brokerage by the commission split alone, rather than by the training and supervision a new licensee needs.

Make it a game · Stem Surgery. One player reads a practice question aloud but stops before the choices. The others race to say, in one sentence, what the question is really asking and to name its qualifier (EXCEPT, NOT, BEST, FIRST or none). Then the reader gives the four choices, and players race to eliminate two aloud, explaining why, before choosing. A point for the qualifier, a point for each correct elimination, two for the right answer. Use the unit tests from this course; play for ten minutes, and let the winner choose the music for the drive to the testing center someday.

Scripture. “Seest thou a man diligent in his business? he shall stand before kings; he shall not stand before mean men.” (Proverbs 22:29, KJV)

Solomon does not promise riches to the diligent but standing — trust, reputation, a place among those who matter. A licensee who prepares thoroughly for the exam and then works with the same care for every family will be trusted with more, because diligence in small things is what people remember.

UNIT 10

The Math, the State Exam and the Road to the License

Twenty-four centuries ago, Egyptian surveyors re-measured flooded fields so that each owner paid tax only on the land the river had left him. Their three questions — how big, what fraction, how much money — are still the questions of every math item on a real estate exam, and this unit gathers them into one toolkit. You will master the **T-bar** of part, whole and rate; area, acreage and volume; the money math of **commissions**, **net listings**, **points**, **loan-to-value**, **mills** and **prorations**, ending with a closing statement that balances to the penny; and the investor's math of **cap rates**, **cash-on-cash return**, **depreciation**, **adjusted basis** and the two great tax rules every licensee must know by number, **Section 121** and **Section 1031**.

Then you will look past the national exam to the **state portion**: what every state tests, what Washington, Oregon, Idaho, Montana and Alaska require according to their own licensing agencies, and how to build a dated facts sheet for any state from official sources. The unit — and the course — ends with exam day itself: the steps to a license in order, the handbook rules, the strategy for four-choice questions, a two-week review plan, the assembled Pathway File and a full-length practice national exam. Keep your basic calculator beside you; this is the most arithmetic-heavy unit in the course, and every answer can be checked.

PREREQUISITES

- Can convert among fractions, decimals and percents and solve a one-step equation for an unknown
- Can compute NOI from potential gross income, vacancy and operating expenses, from Lessons 4.5 and 9.5
- Can explain debits and credits on a closing statement and prorate an item, from Lesson 6.5
- Has every project from Units 1–9 filed and the exam notebook's trap lists current

MASTERY CHECKLIST

- ☐ I can solve any part–whole–rate problem with the T-bar, including percent of change and original cost from a profit or loss.
- ☐ I can find the area of rectangles, triangles, trapezoids and irregular lots, convert to square yards and acres, and compute volume in cubic yards.
- ☐ I can compute the acreage of a rectangular-survey description, adding parcels joined by "and."
- ☐ I can compute commissions and splits, a net-listing price, points, LTV, a month of interest and principal, and PITI.
- ☐ I can compute property tax in mills and transfer tax, prorate taxes and rent by both the 360-day and 365-day methods, and assign debits and credits correctly.
- ☐ I can compute cap rate, value, GRM, cash flow and cash-on-cash return, and straight-line depreciation at 27.5 or 39 years without depreciating land.
- ☐ I can compute adjusted basis and gain, apply the Section 121 exclusion, and explain a Section 1031 exchange with its 45-day and 180-day deadlines and boot.
- ☐ I can state my own state's licensing requirements from its official agency, list the steps to a license in

order, and sit a full-length timed practice exam with a pacing plan.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **IRS Publication 523: Selling Your Home**: Free, official. The IRS's own explanation of the home-sale exclusion — the ownership and use tests, figuring basis and gain, and worksheets. Use it with Lesson 10.3 and its project extension; read it as education, not as advice for any particular sale. Ages 15 and up.
- **IRS: Like-Kind Exchanges — Real Estate Tax Tips**: Free, official. A short IRS page on Section 1031 exchanges of real property, including the identification and exchange periods. Read it during Lesson 10.3 before writing your exchange paragraph. Ages 15 and up.
- **Washington State Department of Licensing: Get Your License — Real Estate Brokers**: Free, official. Washington's own page on the broker license: age and education, the 90 hours, the PSI exams and their timing, fingerprints and the application. Use it with Lesson 10.4; students in other states should find their own commission's equivalent page. Ages 15 and up.
- **Oregon Real Estate Agency: Broker Licensing**: Free, official. Oregon's step-by-step path to the broker license, from the 150 hours to the PSI exam and association with a principal broker. Use it with Lesson 10.4 as a model of what to look for on any state's site. Ages 15 and up.
- **Idaho Real Estate Commission (DOPL): Education for Applicants**: Free, official. Idaho's description of the two 45-hour salesperson modules and the three-year time limit, with links to the Commission's other licensing pages. Use it with Lesson 10.4's practice set. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

10.1	**The Math Toolkit: Percentages, Area and Acreage**	3 sessions of 50 minutes
10.2	**Money Math: Commissions, Loans, Taxes and Prorations**	3 sessions of 50 minutes
10.3	**Investment Math and the Taxman**	3 sessions of 50 minutes
10.4	**The State Portion: License Law in the Northwest and Beyond**	

Unit 10 test

Closed book, closed notebook, basic calculator only. Twenty four-choice questions, 5 points each, 100 points total. Allow about a minute and a half per question — set a timer for 30 minutes and finish inside it, as you will at the testing center. Answer every question; there is no penalty for guessing. Seventy percent — 14 of 20 — matches the common passing line, but aim higher. Figures marked “in this example” are examples; real commission rates, tax rates and state rules are set by negotiation, by local law and by your state’s licensing agency. Show your work on scratch paper, estimate before you calculate, and choose the one BEST answer.

1. **5 pts**

   A home sold for $378,000, which was 90% of its list price. What was the list price?

   A. $340,200

   B. $415,800

   C. $420,000

   D. $396,900

2. **5 pts**

   How many acres are in the NW¼ of the NE¼ of the SE¼ of a section?

   A. 10

   B. 40

   C. 20

   D. 2.5

3. 5 pts

A lot has two parallel sides of 100 feet and 140 feet, 180 feet apart. What is its area?

A. 25,200 sq ft

B. 21,600 sq ft

C. 18,000 sq ft

D. 12,600 sq ft

4. 5 pts

An owner bought a lot for $250,000 and sold it for $215,000. What was the percent of loss?

A. 16.3%

B. 35%

C. 86%

D. 14%

5. 5 pts

In this example a $380,000 sale carries a 6% commission, split equally between the listing and cooperating brokerages. The cooperating agent receives 60% of her brokerage's share. What does she receive?

A. $6,840

B. $11,400

C. $13,680

D. $4,560

6. 5 pts

A seller wants to net $300,000 after a 5% commission (in this example) and $4,000 of other costs. What is the lowest sale price that does it?

A. $319,200

B. $315,000

C. $320,000

D. $304,000

7. 5 pts

A buyer purchases a $400,000 home with an 85% loan and pays 2 discount points. What do the points cost?

A. $8,000

B. $6,800

C. $3,400

D. $680

8. 5 pts

A property is assessed at $180,000, and the tax rate is 32 mills. What is the annual tax?

A. $576

B. $57,600

C. $3,200

D. $5,760

9. 5 pts

Annual taxes of $3,650 are paid in arrears. Closing is April 11; the buyer owns the day of closing. Using a 365-day year, what is the proration and entry?

A. $1,000, debit buyer and credit seller

B. $1,000, debit seller and credit buyer

C. $1,010, debit seller and credit buyer

D. $2,650, debit seller and credit buyer

10. 5 pts

How much interest is due in the first month on a $250,000 loan at 6% annual interest?

A. $1,250

B. $15,000

C. $1,500

D. $125

11. 5 pts

A building's NOI is $48,000, and the market cap rate is 8%. What is its value?

A. $384,000

B. $480,000

C. $600,000

D. $640,000

12. 5 pts

An investor buys a residential rental property for $500,000, of which $115,000 is land value. What is the annual straight-line depreciation?

A. $18,181.82

B. $12,820.51

C. $9,871.79

D. $14,000

13. 5 pts

A married couple filing jointly, who have owned and lived in their home for six years, realize a gain of $560,000 on its sale. How much of the gain is taxable?

A. $60,000

B. $310,000

C. $0

D. $560,000

14. 5 pts

In a delayed Section 1031 exchange, the investor must identify replacement property and acquire it within:

A. 30 days and 90 days

B. 45 days and 180 days

C. 60 days and 180 days

D. 45 days and 120 days

15. 5 pts

An owner bought a rental for $220,000, added $30,000 of capital improvements and has taken $40,000 of depreciation. What is the adjusted basis?

A. $290,000

B. $250,000

C. $210,000

D. $180,000

16. 5 pts

A house renting for $2,700 a month sold for $297,000. What is its gross rent multiplier?

A. 9.17

B. 1.1

C. 91.7

D. 110

17. 5 pts

Among Washington, Oregon, Idaho, Montana and Alaska, which state's minimum licensing age is 19, as of 2026?

A. Alaska

B. Oregon

C. Montana

D. Idaho

18. 5 pts

The most reliable source for your state exam's ID rules, calculator policy, passing score and retake rules is:

A. An exam-prep video

B. An online forum

C. The testing vendor's candidate handbook for your state

D. A trade association newsletter

19. 5 pts

On a question asking which choice is NOT true of a topic, the best approach is to:

A. Choose the first true statement you find

B. Treat each choice as true or false and select the false one

C. Choose the longest answer

D. Skip it, since there is a penalty for guessing

20. 5 pts

A concrete patio 30 feet by 20 feet is poured 6 inches thick. About how many cubic yards of concrete are needed?

A. 3,600

B. 100

C. 33.3

D. 11.1

ANSWER KEY

1. C. Whole = part ÷ rate: $\$378{,}000 \div 0.90 = \$420{,}000$. B adds 10% of the sale price, taking the percent of the wrong whole.
2. A. $640 \times \frac{1}{4} \times \frac{1}{4} \times \frac{1}{4} = 10$ acres. B stops after two fractions.
3. B. Trapezoid: $\frac{1}{2} \times (100 + 140) \times 180 = 21{,}600$ sq ft. A uses only the longer side; C only the shorter.
4. D. $(\$250{,}000 - \$215{,}000) \div \$250{,}000 = 0.14$. A divides by the sale price instead of the original cost.
5. A. $\$380{,}000 \times 0.06 = \$22{,}800$; half is $\$11{,}400$; $\$11{,}400 \times 0.60 = \$6{,}840$. C applies 60% to the whole commission.
6. C. $(\$300{,}000 + \$4{,}000) \div 0.95 = \$320{,}000$. A adds 5% to $\$304{,}000$, which leaves the seller $\$760$ short.
7. B. The loan is $\$400{,}000 \times 0.85 = \$340{,}000$, and 2 points are $\$340{,}000 \times 0.02 = \$6{,}800$. A computes points on the price.
8. D. 32 mills = 0.032; $\$180{,}000 \times 0.032 = \$5{,}760$. B treats mills as percent.
9. B. Seller's days: $31 + 28 + 31 + 10 = 100$; $\$3{,}650 \div 365 = \$10$ a day, so $\$1{,}000$. Taxes in arrears are unpaid for the seller's days: debit seller, credit buyer. A reverses the entry.
10. A. $\$250{,}000 \times 0.06 \div 12 = \$1{,}250$. B is a full year's interest.
11. C. Value = NOI ÷ rate: $\$48{,}000 \div 0.08 = \$600{,}000$. A multiplies by the rate instead of dividing by it.
12. D. Land is never depreciated: $(\$500{,}000 - \$115{,}000) \div 27.5 = \$14{,}000$. A includes the land; C uses the 39-year nonresidential life.
13. A. They meet the two-of-five-year test, so up to $\$500{,}000$ is excluded under Section 121: $\$560{,}000 - \$500{,}000 = \$60{,}000$. B applies the single-filer $\$250{,}000$ limit.
14. B. 45 days to identify and 180 days to acquire, counted from the transfer of the property given up.
15. C. $\$220{,}000 + \$30{,}000 - \$40{,}000 = \$210{,}000$. A adds the depreciation instead of subtracting it.
16. D. GRM = price ÷ monthly rent: $\$297{,}000 \div \$2{,}700 = 110$. A divides by annual rent, the gross income multiplier used for commercial property.
17. A. Alaska requires salesperson applicants to be 19; the other four require 18. Always confirm with the state's agency.

18. C. The candidate handbook, linked from the state commission's site, is the official rulebook for the exam; other sources may be outdated or wrong.
19. B. An EXCEPT or NOT question hides three true statements and one false one. D is wrong twice: never skip, and there is no penalty for guessing.
20. D. $30 \times 20 \times 0.5 = 300$ cubic feet; $300 \div 27 \approx 11.1$ cubic yards. A forgets to convert inches to feet; C divides by 9 instead of 27.

PORTFOLIO PIECE: MY PATHWAY FILE — THE MATH PAGES AND THE ROAD AHEAD

Complete your Pathway File with the last unit's work: the Formula Card and the real county parcel measured, converted to acres and compared with the assessor's figure (10.1); the Closing Calculator spreadsheet with its commission, loan, proration and two-sided closing statement blocks, tested against the lesson's examples (10.2); the Investment Analysis Worksheet for a pretend four-unit building, from NOI and cap rate to depreciation, gain and a 1031 paragraph, clearly labeled an educational exercise (10.3); My State Facts Sheet, sourced and dated from your state's agency and candidate handbook (10.4); and the Road-to-License Plan, the exam-day handbook card and the two-week review calendar (10.5).

Then assemble the whole binder — one tab per unit, the formula card and state facts sheet at the front — and add the capstone: your scored, honestly proctored practice final, your score by unit, every miss corrected and explained, and the sealed letter to your future licensed self. Date every page. This binder is the record of a year's work and the beginning of a professional life.

LOOK FOR	WHAT IT MEANS
Formula Card and real parcel	Every toolkit formula appears with a correct example; the parcel is sketched to scale, split into shapes, converted to acres and compared with the assessor's figure with a reasoned explanation of any difference.
Closing Calculator	All blocks use formulas rather than typed numbers; commissions, points, LTV, interest, PITI and both proration methods are correct; the closing statement balances and reproduces the lesson's seller's net and cash to close.
Investment Analysis Worksheet	NOI, value, GRM, cash flow, cash-on-cash return, depreciation (land excluded), adjusted basis and gain are all correct, and the 1031 paragraph uses each required term accurately and labels the work as education, not advice.
State Facts Sheet	All nine state-portion topics are covered with facts taken only from official sources, every fact is dated and cited, and the timeline shows every time limit correctly.
Road-to-License Plan and practice final	The nine steps are adapted to the student's own state with realistic dates; the practice final was taken under honest timed

LOOK FOR	WHAT IT MEANS
	conditions, scored by unit, and every miss is corrected with a reason.
Assembled Pathway File	All ten units are present, tabbed and in lesson order, every page is dated, and the binder reads as a coherent professional record.

COURSE EXAM

Midterm Exam

Covers Units 1–5. Time: 90 minutes.

Closed book, closed notebook, basic calculator only. Sixty four-choice questions on Units 1–5, one point each. Take the whole exam in one sitting with a 90-minute limit — about a minute and a half per question — with a parent or proctor keeping time. Choose the one BEST answer, and answer every question: there is no penalty for guessing, so a blank is a sure miss. Flag the hard ones, keep moving, and return to them if time remains. To score it, divide the number correct by 60 and multiply by 100 for your percent correct; 42 correct (70%) matches the common passing line, but aim higher. Figures marked “in this example” are examples, not current rates, fees or limits. Afterward, review every miss in your exam notebook: write the point the question tested, why the right answer is right and why the choice you made was wrong, then reread that lesson’s “On the exam today” paragraph.

---

1. **1 pt** **Lesson 1.1**

   A seller agrees to leave her freestanding patio furniture and a portable refrigerator for the buyer. The document normally used to transfer these items is a:

   A. Bill of sale

   B. General warranty deed

   C. Deed of trust

   D. Quitclaim deed

2. **1 pt** **Lesson 1.1**

   A dentist leasing an office bolted two dental chairs to the floor for her practice. Her lease ends on August 31 and says nothing about the chairs. Which statement is correct?

   A. They became the landlord’s property once they were bolted down

   B. She may remove them within a reasonable time after August 31

   C. She may remove them by August 31 if she repairs any damage

   D. They pass to the landlord unless she pays for the floor

3. 1 pt **Lesson 1.2**

A tornado flattens every building on a farm, yet the land itself remains and still has value. This BEST illustrates which characteristic of land?

A. Immobility

B. Scarcity

C. Nonhomogeneity

D. Indestructibility

4. 1 pt **Lesson 1.2**

Real estate is called an illiquid investment because money spent on land and buildings is fixed in place and recovered slowly. This economic characteristic is:

A. Area preference (situs)

B. Permanence of investment (fixity)

C. Improvements (modification)

D. Uniqueness (nonhomogeneity)

5. 1 pt **Lesson 1.3**

In older deeds, a Gunter's chain — a unit the exam still uses — equals:

A. 16½ feet

B. 100 feet

C. 33 feet

D. 66 feet

6. 1 pt **Lesson 1.3**

A buyer's title search comes back clean, but after closing she learns that the neighbor's garage sits two feet over her lot line. What would MOST likely have revealed the problem before closing?

A. A standard-coverage owner's title policy

B. A survey by a licensed land surveyor

C. A longer search of the recorded chain of title

D. The county assessor's parcel map

7. 1 pt **Lesson 1.4**

How many acres are in “the S½ of the SE¼ and the SW¼ of the NE¼ of the SE¼ of Section 20”?

A. 10 acres

B. 50 acres

C. 90 acres

D. 170 acres

8. 1 pt **Lesson 1.4**

A standard township in the rectangular survey contains:

A. 36 sections, or 36 square miles

B. 6 sections, or 6 square miles

C. 36 sections, or 640 acres

D. 16 sections, or 16 square miles

9. 1 pt **Lesson 1.4**

In a standard township, which section lies directly south of Section 6?

A. Section 7

B. Section 12

C. Section 5

D. Section 31

10. 1 pt **Lesson 1.5**

Land that is exposed when a lake or river permanently recedes is called:

A. Avulsion

B. Alluvion

C. Erosion

D. Reliction

11. 1 pt **Lesson 1.5**

A rancher sells her land but keeps the oil and gas rights for herself. The result is BEST described as:

A. A life estate

B. A tenancy in common

C. A split estate

D. An easement in gross

12. (1 pt) **Lesson 2.1**

A deed conveys a camp “to the Mission Society, but if the land is ever used for commercial purposes, the grantor may re-enter and reclaim it.” The Society holds:

A. A fee simple determinable with a possibility of reverter

B. A fee simple subject to a condition subsequent

C. A life estate pur autre vie

D. A fee simple absolute with no conditions

13. (1 pt) **Lesson 2.1**

A grantor deeds a house “to my brother for life.” The deed names no one to take the property afterward. When the brother dies, the house:

A. Returns to the grantor or the grantor’s heirs by reversion

B. Passes to the brother’s heirs as a remainder

C. Escheats to the state because no one else was named in the deed

D. Passes to the brother’s estate in fee simple

14. (1 pt) **Lesson 2.2**

A tenant’s leasehold estate is classified as:

A. Real property, called a freehold estate

B. Real property, called a leased fee

C. Personal property, called an emblement

D. Personal property, called a chattel real

15. (1 pt) **Lesson 2.2**

A tenant’s one-year lease ended on March 31. She stays on, and on April 1 the landlord accepts her usual monthly rent payment without objection. In most states she now holds:

A. An estate at sufferance

B. A new estate for one more year

C. A periodic, month-to-month tenancy

D. An estate at will that ends at any sale

16. 1 pt **Lesson 2.3**

Which statement about tenancy in common is correct?

A. Co-owners must hold equal shares acquired by one deed

B. Co-owners may hold unequal shares and may leave them by will

C. A deceased co-owner's share passes to the others automatically

D. It requires the unities of possession, interest, time and title

17. 1 pt **Lesson 2.3**

A married couple in Washington buys a house during the marriage with their wages, titled only in the wife's name. The husband owned a cabin before they married. Which is correct?

A. The house is her separate property because only her name is on title

B. The house is community property; the cabin is his separate property

C. Both the house and the cabin are community property

D. The couple owns the house and the cabin as joint tenants

18. 1 pt **Lesson 2.3**

Three siblings inherit one house as tenants in common. One wants to sell; the other two refuse. Her remedy is to:

A. Sell the entire house herself, since she owns an undivided interest

B. Demand that the others buy her share at a price she names

C. File a partition action, likely ending in a court-ordered sale

D. Record a lis pendens, which forces the others to sell

19. 1 pt **Lesson 2.4**

In a condominium, a balcony that the declaration reserves for the use of one unit is a:

A. Limited common element

B. General common element

C. Separate fee simple parcel

D. Proprietary leasehold

20. 1 pt **Lesson 2.4**

In a planned unit development, the community pool and parks are usually owned by:

A. All lot owners as tenants in common

B. The developer, permanently

C. The county parks department

D. The owners' association

21. 1 pt **Lesson 2.5**

A roofer who was never paid files a lien against the house he reroofed. This lien is BEST classified as:

A. General, voluntary and equitable

B. Specific, voluntary and equitable

C. Specific, involuntary and statutory

D. General, involuntary and statutory

22. 1 pt **Lesson 2.5**

An owner divides his farm and sells the back parcel, which has no road access except across the land he keeps. The deed says nothing about access. The buyer most likely holds:

A. An easement by necessity, which ends if the need ends

B. An easement in gross, which the buyer may sell

C. An easement by prescription, after ten years of open use

D. A license, which the seller may revoke at any time

23. 1 pt **Lesson 2.5**

A recorded notice warning that a lawsuit affecting title to a property is pending is a:

A. Satisfaction of mortgage

B. Subordination agreement

C. Deed of reconveyance

D. Lis pendens

24. 1 pt **Lesson 3.1**

A state dam repeatedly floods part of a farm, making it unusable, but the state has never filed a condemnation case. The owner's remedy is:

A. A partition action

B. Inverse condemnation

C. A quiet title action

D. A claim of escheat

25. 1 pt **Lesson 3.1**

A city declares a fire-damaged building unsafe and orders it vacated and "condemned." Which power has the city used, and with what result?

A. Police power; the owner keeps title and is not paid

B. Eminent domain; the city must pay fair market value

C. Escheat; the building passes to the city once vacated

D. Taxation; the city takes title for unpaid taxes

26. 1 pt **Lesson 3.2**

A church wants to build in a residential district where the zoning ordinance allows churches if the board approves. The church should apply for a:

A. Variance

B. Conditional use permit

C. Zoning amendment (rezoning)

D. Nonconforming use

27. 1 pt **Lesson 3.2**

Zoning ordinances are supposed to carry out the community's:

A. Recorded CC&Rs

B. Building code

C. Comprehensive (master) plan

D. Subdivision plat

28. (1 pt) **Lesson 3.2**

Under the Interstate Land Sales Full Disclosure Act, a buyer of a lot in a covered subdivision who received the property report before signing may cancel within:

A. Three business days of closing

B. Thirty days of signing

C. Two years of closing

D. Seven days of signing

29. (1 pt) **Lesson 3.3**

After closing on a lot, a buyer says he is not bound by the subdivision's recorded CC&Rs because no one ever gave him a copy. He is:

A. Not bound, because he had no actual notice

B. Bound, because recording gives constructive notice

C. Bound only if he signed the declaration himself at closing

D. Not bound unless the city chooses to enforce them

30. (1 pt) **Lesson 3.3**

Racially restrictive covenants that still appear in some old recorded deeds are:

A. Void and unenforceable

B. Enforceable if recorded before 1948

C. Enforceable only by the owners' association

D. Valid until the owners vote to remove them

31. (1 pt) **Lesson 3.4**

In this example, a home's market value is $420,000, the assessment ratio is 75%, the owner has a $15,000 homestead exemption from assessed value, and the tax rate is $2.80 per $100 of taxable value. What is the annual tax?

A. $840

B. $8,400

C. $8,820

D. $11,340

32. 1 pt **Lesson 3.4**

The general real property tax is called an ad valorem tax because it is levied:

A. According to the lot's front footage

B. At the same flat amount per parcel

C. According to the owner's income

D. According to the property's value

33. 1 pt **Lesson 3.5**

A landlord rents out a house built in 1960. Under the federal lead-based paint rule, which requirement applies to buyers but NOT to tenants?

A. Receipt of the EPA lead hazard pamphlet

B. A Lead Warning Statement in the lease or contract

C. A 10-day opportunity to test for lead

D. Disclosure of known lead-based paint and reports

34. 1 pt **Lesson 3.5**

A Phase I environmental site assessment includes all of the following EXCEPT:

A. Soil and groundwater sampling

B. A review of the property's historical records

C. An inspection of the site

D. Interviews with owners and occupants

35. 1 pt **Lesson 3.5**

A buyer plans to fill a marshy, saturated corner of a rural lot to build a shop. Which federal law may require a permit from the U.S. Army Corps of Engineers first?

A. CERCLA (Superfund)

B. The Clean Air Act

C. Section 404 of the Clean Water Act

D. The Interstate Land Sales Full Disclosure Act

36. 1 pt **Lesson 4.1**

A modest two-bedroom cottage on a street of large, expensive homes sells for more than identical cottages in other neighborhoods. This illustrates:

A. Regression

B. Conformity

C. Plottage

D. Progression

37. 1 pt **Lesson 4.1**

The principle that an informed buyer will pay no more for a property than the cost of acquiring an equally desirable substitute is:

A. Contribution

B. Anticipation

C. Competition

D. Substitution

38. 1 pt **Lesson 4.1**

Market value is BEST defined as:

A. The most probable price in a fair, open-market sale

B. The price actually paid in the most recent sale

C. The cost to build the improvements new, plus the land

D. The value the assessor sets for property taxes

39. 1 pt **Lesson 4.2**

An appraiser inspects a house on May 4 and signs the report on May 19. For a current-value assignment, the opinion of value applies as of:

A. May 19, the report date

B. May 4, the effective date

C. The scheduled closing date

D. The date the offer was accepted

40. 1 pt **Lesson 4.2**

Which appraiser credential is needed to appraise a shopping center?

A. Certified residential appraiser

B. Licensed residential appraiser

C. Certified general appraiser

D. Appraiser trainee

41. 1 pt **Lesson 4.2**

A loan officer tells an appraiser, “This one has to come in at $510,000 or the deal dies,” and promises more assignments if it does. This conduct:

A. Is allowed because the lender ordered the appraisal

B. Is allowed if one comparable supports $510,000

C. Violates only the Fair Housing Act

D. Violates appraiser independence rules

42. 1 pt **Lesson 4.3**

In this example, the subject has no garage. A comparable sold four months ago for $360,000; it has a two-car garage, which the market values at $15,000, and prices have risen 3% since it sold. What is the comparable’s adjusted price?

A. $334,200

B. $345,000

C. $355,800

D. $385,800

43. 1 pt **Lesson 4.3**

In reconciling three adjusted comparable prices, an appraiser should give the MOST weight to the comparable that:

A. Sold for the highest price of the three

B. Needed the fewest and smallest adjustments

C. Has the smallest net adjustment of the three

D. Stayed on the market longest before selling

44. (1 pt) **Lesson 4.3**

A comparable sold for $412,000, but the seller paid $8,000 of the buyer's closing costs. The appraiser will most likely:

A. Adjust the comparable's price downward for the concession

B. Adjust the subject's value upward by $8,000

C. Ignore the concession, since concessions are paid at closing

D. Adjust the comparable's price upward by $8,000

45. (1 pt) **Lesson 4.4**

A house's fourth bedroom can be reached only by walking through the third bedroom. In the cost approach, this loss in value is BEST classified as:

A. External obsolescence, always incurable

B. Physical deterioration, curable

C. Functional obsolescence, always curable at low cost

D. Functional obsolescence, usually incurable

46. (1 pt) **Lesson 4.4**

Which method of estimating cost new is the most detailed, pricing every quantity of material and hour of labor as a contractor bids a job?

A. Quantity survey method

B. Square-foot method

C. Unit-in-place method

D. Index method

47. (1 pt) **Lesson 4.5**

In this example, a 10-unit building rents each unit for $1,500 a month. Vacancy and collection loss is 5%, annual operating expenses are $66,000, and the owner's annual mortgage payments are $54,000. At an 8% capitalization rate, the indicated value is:

A. $637,500

B. $1,312,500

C. $1,425,000

D. $2,250,000

48. 1 pt Lesson 4.5

If a property's net operating income stays the same while the market capitalization rate rises, its indicated value:

A. Increases

B. Does not change

C. Decreases

D. Changes only if rents change

49. 1 pt Lesson 5.1

The document that is the evidence of the debt and makes the borrower personally liable is the:

A. Mortgage

B. Deed of trust

C. Deed of reconveyance

D. Promissory note

50. 1 pt Lesson 5.1

The clause that lets a lender declare the entire remaining balance due at once when the borrower defaults is the:

A. Alienation (due-on-sale) clause

B. Defeasance clause

C. Acceleration clause

D. Release clause

51. 1 pt Lesson 5.1

A buyer assumes a seller's FHA loan with the lender's approval, and the lender signs a novation releasing the seller. If the buyer later defaults, who is personally liable on the note?

A. The buyer only

B. The seller only

C. Both the buyer and the seller

D. Neither, because FHA insures the loan

52. 1 pt **Lesson 5.2**

A buyer agrees to pay $360,000 for a house that appraises at $350,000. The lender will lend 90% of value. What is the largest loan, and how much must the buyer put down?

A. $324,000 loan; $36,000 down

B. $315,000 loan; $45,000 down

C. $315,000 loan; $35,000 down

D. $306,000 loan; $54,000 down

53. 1 pt **Lesson 5.2**

In a fully amortized, fixed-rate loan, as the months pass:

A. The payment is level; the interest share falls

B. The payment falls each month as the balance falls

C. The interest share rises as principal shrinks

D. The payment rises once each year to keep pace

54. 1 pt **Lesson 5.3**

Which document shows that a borrower is eligible for a VA-guaranteed home loan?

A. Notice of value

B. Loan Estimate

C. Certificate of occupancy

D. Certificate of eligibility

55. 1 pt **Lesson 5.3**

On a conventional loan, lenders commonly require private mortgage insurance when the loan-to-value ratio is above:

A. 70%

B. 90%

C. 80%

D. 97%

56. 1 pt **Lesson 5.3**

A conventional loan larger than the limit set for purchase by Fannie Mae and Freddie Mac is a:

A. Conforming loan

B. Jumbo (nonconforming) loan

C. Purchase-money loan

D. Package loan

57. 1 pt **Lesson 5.4**

An ARM's interest rate is figured as the index plus the margin. Over the life of the loan, which of these never changes?

A. The margin

B. The index

C. The fully indexed rate

D. The required monthly payment

58. 1 pt **Lesson 5.4**

A couple wants to buy a new home before their current home sells, so they borrow short-term against the current home's equity for the down payment. This is a:

A. Wraparound loan

B. Blanket loan

C. Reverse mortgage

D. Bridge (swing) loan

59. 1 pt **Lesson 5.5**

Which statement BEST describes the secondary mortgage market?

A. Lenders originate new loans directly to home buyers

B. Existing loans are bought and sold among investors

C. The Federal Reserve lends directly to families

D. Mortgage brokers fund loans from their own capital

60. 1 pt **Lesson 5.5**

In a deed-of-trust state, a borrower defaults. Without any lawsuit, the property is sold at public auction after the notices the state statute requires. This is:

A. Judicial foreclosure by the sheriff

B. Strict foreclosure by the court

C. Nonjudicial foreclosure by the trustee

D. A deed in lieu of foreclosure

ANSWER KEY

1. A. These items are movable personal property (chattels), and personal property is transferred by a bill of sale. A deed — warranty (B) or quitclaim (D) — conveys real property, and a deed of trust (C) secures a loan.
2. C. The chairs are trade fixtures — equipment a tenant installs for her business — so they stay her personal property, removable before the lease expires if she repairs the damage. B is the trap: trade fixtures left after the lease ends become the landlord's by accession, so the deadline is the end of the lease.
3. D. Land is permanent even when the improvements on it are destroyed — indestructibility, the reason appraisers depreciate buildings but never land. Immobility (A) means land cannot be moved, and scarcity (B) is an economic characteristic about supply.
4. B. Permanence of investment, also called fixity, describes capital locked into land and buildings for decades. Situs (A) is people's preference for a location, and uniqueness (D) is a physical characteristic, not an economic one.
5. D. A chain is 66 feet: 100 links, or 4 rods. A is the length of a rod (also called a pole or perch) — the most common swap on the exam.
6. B. An encroachment is a physical fact on the ground, not a recorded document, so a survey reveals it. A title search (C) examines the public records, and standard title coverage (A) excepts matters that only a survey or inspection would show.
7. C. The word "and" joins two parcels, so compute each and add: $640 \times \frac{1}{2} \times \frac{1}{4} = 80$ acres and $640 \times \frac{1}{4} \times \frac{1}{4} \times \frac{1}{4} = 10$ acres, for 90 acres. A counts only the second parcel, and D forgets the ½ in the first.
8. A. A township is 6 miles square — 36 square miles — divided into 36 sections of one square mile (640 acres) each. B is the classic trap: "6 miles square" is not "6 square miles," and 640 acres (C) is a single section.
9. A. Section 6 is in the northwest corner. The numbers snake back and forth, so the second row runs west to east, 7 through 12, putting Section 7 directly below Section 6. B lies below Section 1 in the northeast corner, and D is the southwest corner of the township.
10. D. Reliction (also called dereliction) adds land as water permanently recedes, and the new land generally belongs to the shoreline owner. Alluvion (B) is the soil deposited by accretion; avulsion (A) is a sudden loss of land by a natural force.

11. C. Subsurface rights can be severed from the surface: the buyer owns the surface, and the rancher keeps the minerals, which she may later lease or sell — a split estate. Tenants in common (B) share undivided interests in the whole, which is not the case here.
12. B. “But if … may re-enter” is the language of a condition subsequent: if the condition is broken, the grantor holds a right of re-entry and must act to retake the land. A fee simple determinable (A) uses words of duration such as “so long as” and ends automatically.
13. A. When a life estate ends and the deed names no third party, the property comes back to the grantor or the grantor’s heirs — a reversion. A remainder (B) requires a named third party, and escheat (C) applies only when an owner dies with no will and no heirs.
14. D. Because the tenant holds possession for a term rather than ownership of the fee, a leasehold is personal property — a chattel real. The leased fee (B) is the landlord’s interest, and emblements (C) are annual crops.
15. C. A holdover tenant is at sufferance only until the landlord consents; accepting monthly rent commonly creates a periodic (month-to-month) tenancy that renews until proper notice is given. A describes her status before the landlord accepted the rent.
16. B. Tenants in common need only unity of possession; shares may be unequal, and each share passes by will or inheritance. Survivorship (C) and the four unities (D) describe joint tenancy.
17. B. In a community property state such as Washington, property acquired during the marriage with earnings belongs equally to both spouses whatever the title says, while property owned before the marriage stays separate. A is the trap — the name on the title does not decide it.
18. C. Any tenant in common may ask a court for partition. A single house cannot be fairly divided in kind, so the court will likely order partition by sale and divide the proceeds by share. She may sell only her own share, not the whole house (A).
19. A. A common element reserved for one unit or a few — an assigned balcony, parking space or storage locker — is a limited common element, still owned by all the owners as tenants in common. A proprietary lease (D) belongs to a cooperative.
20. D. In a PUD each owner holds his lot and home in fee, and the owners’ association owns the common areas. A describes a condominium’s common

elements — a frequent exam swap.

21. C. A mechanic's lien attaches only to the improved property (specific), arises without the owner's consent (involuntary) and is created by statute. A recorded judgment lien would be general (D); a mortgage is the classic voluntary lien.
22. A. When a tract is divided and a parcel is left landlocked, the law implies an easement by necessity over the land it came from, lasting only while the necessity lasts — for example, until a public road reaches it. Prescription (C) requires years of hostile use.
23. D. A lis pendens ("suit pending") warns that anyone who buys or lends now takes subject to the lawsuit's outcome. A satisfaction (A) and a reconveyance (C) release a paid-off loan, and a subordination agreement (B) changes lien priority.
24. B. Inverse condemnation is the owner's lawsuit against a government that has effectively taken or damaged property without condemning it. Escheat (D) is the state receiving the property of an owner who died with no will and no heirs.
25. A. Declaring a building unfit to occupy is a safety regulation — police power — and it transfers no title and requires no payment. B is the trap: the everyday word "condemned" here does not mean condemnation under eminent domain.
26. B. A conditional (special) use permit allows a use the ordinance already lists as permissible under conditions. A variance (A) is relief from a dimensional rule such as a setback, and a rezoning (C) changes the district itself.
27. C. Zoning rests on the comprehensive plan — the long-range plan for land use, roads, utilities and growth. CC&Rs (A) are private restrictions, and the building code (B) governs how structures are built, not what may be built where.
28. D. The Act gives a seven-day cooling-off period after signing. Two years (C) is how long a buyer who never received the property report may revoke.
29. B. Recorded restrictions give constructive notice to every later buyer, so he takes subject to them whether or not he read them. CC&Rs are enforced by the association and the benefited owners, not by the city (D).
30. A. In *Shelley v. Kraemer* (1948) the Supreme Court held that courts may not enforce such covenants, and the Fair Housing Act of 1968 made them unlawful. Whatever the old record says, they are void.
31. B. Assessed value: $\$420{,}000 \times 0.75 = \$315{,}000$. Taxable value: $\$315{,}000 - \$15{,}000 = \$300{,}000$. Tax: $3{,}000 \times \$2.80 = \$8{,}400$. C forgets the exemption, D applies the rate to market value, and A reads the rate as per $1,000.

32. D. Ad valorem means “according to value”: market value times the assessment ratio, less exemptions, times the rate. Special assessments, by contrast, are often apportioned by front footage (A) or by benefit.
33. C. Tenants receive the disclosure, any reports, the EPA pamphlet and the warning statement, but only buyers are offered the 10-day opportunity to test. Watch the qualifier NOT.
34. A. A Phase I is records, a site visit and interviews, with no sampling. Sampling soil and water is a Phase II, ordered when the Phase I finds a recognized environmental condition.
35. C. Filling or dredging regulated wetlands generally requires a Section 404 permit from the Army Corps of Engineers, with EPA oversight. CERCLA (A) governs the cleanup of hazardous waste sites.
36. D. Progression: a lesser property gains value from better neighbors. Regression (A) is the reverse — the best house on a modest street is held down by its neighbors.
37. D. Substitution is the root of all three approaches to value. Contribution (A) measures what a component adds, and anticipation (B) says value comes from expected future benefits.
38. A. Market value is the most probable price a property should bring in a competitive, open market, with buyer and seller informed, typically motivated and dealing at arm’s length. Price (B) is what someone paid, cost (C) is what it takes to build, and assessed value (D) serves taxation.
39. B. The effective date is the date the value applies to — normally the inspection date for a current value. The report date (A) is simply when the report was written, a distinction the exam tests.
40. C. Only a certified general appraiser may appraise all types of real property, including commercial property. Licensed and certified residential appraisers (B, A) are limited to one-to-four-unit residential property.
41. D. Federal lending rules and USPAP forbid anyone to pressure an appraiser toward a predetermined value, and an appraiser may not accept work contingent on reporting one. Ordering the appraisal (A) gives the lender no right to dictate the number.
42. C. Adjust for market conditions first: $\$360{,}000 \times 1.03 = \$370{,}800$. The comparable is better — it has a garage the subject lacks — so subtract: $\$370{,}800 - \$15{,}000 = \$355{,}800$. D adds the garage (comp better, subtract), and B skips the time adjustment.

43. B. The most similar comparable — the one with the fewest and smallest adjustments, measured by gross adjustment — is the most reliable. A small net adjustment (C) can hide large plus and minus adjustments that cancel each other out.

44. A. A seller concession can inflate the recorded price above a cash-equivalent value, so the comparable is typically adjusted down — by up to the concession, as the market shows. Adjustments are always made to the comparable, never to the subject (B).

45. D. A floor-plan flaw built into the structure is functional obsolescence, and because fixing it would cost more than it adds, it is usually incurable. External obsolescence (A) comes from causes outside the property line.

46. A. The quantity survey method is the most detailed and accurate. The square-foot method (B) — area times a current cost per square foot — is the most common, and unit-in-place (C) prices each installed component.

47. B. Potential gross income: $10 \times \$1{,}500 \times 12 = \$180{,}000$; less 5% vacancy, EGI is $\$180{,}000 - \$9{,}000 = \$171{,}000$. NOI: $\$171{,}000 - \$66{,}000 = \$105{,}000$, and value is $\$105{,}000 \div 0.08 = \$1{,}312{,}500$. A subtracts the mortgage payments, which are never operating expenses; C forgets vacancy.

48. C. Value equals income divided by rate, so a higher cap rate means a lower value — buyers demand a higher return from riskier property. Choosing A is the classic reversal.

49. D. The note is the borrower's promise to pay. The mortgage or deed of trust (A, B) is the security instrument that pledges the property for that debt.

50. C. Acceleration is the remedy that makes the whole balance due on default. The alienation clause (A) is triggered by a transfer of the property, and the defeasance clause (B) operates at payoff.

51. A. By assuming, the buyer became personally liable, and the novation substituted him for the seller and released her. Without the novation, both would be liable (C).

52. B. LTV uses the lesser of price and appraisal: $0.90 \times \$350{,}000 = \$315{,}000$. The buyer still owes the full price, so the down payment is $\$360{,}000 - \$315{,}000 = \$45{,}000$. A bases the loan on the price, and C forgets that the buyer covers the appraisal shortfall.

53. A. The payment is level, but interest is charged on a shrinking balance, so the interest portion falls each month and the principal portion grows by the same amount. C reverses the pattern.

54. D. The certificate of eligibility (COE) proves eligibility and shows the available entitlement. The Notice of Value (A) comes from the VA appraisal, and a certificate of occupancy (C) comes from the building department.
55. C. Above 80% LTV the lender commonly requires PMI to cover part of its loss on default. Under the Homeowners Protection Act the borrower may later request cancellation at 80% of original value.
56. B. A loan above the conforming limit cannot be sold to Fannie Mae or Freddie Mac, so it is nonconforming — a jumbo. A package loan (D) covers personal property along with the real estate.
57. A. The index moves with the market; the margin is the lender's fixed percentage, written into the note for the life of the loan. The fully indexed rate (C) is index plus margin, so it moves with the index.
58. D. A bridge loan lets an owner buy before selling, secured by the old home and repaid when it sells. A blanket loan (B) covers several parcels, and a wraparound (A) is a new junior loan that includes an existing one.
59. B. In the secondary market, investors buy existing loans — usually pooled into mortgage-backed securities — so lenders get cash to lend again. Originating loans (A) is the primary market, and the Federal Reserve (C) conducts monetary policy rather than lending to families.
60. C. Under a power-of-sale clause, the trustee sells at a trustee's sale after the statutory notices, with no court case — the usual path in deed-of-trust states such as Washington and Oregon. Judicial foreclosure (A) runs through a lawsuit and a court-ordered sale.

COURSE EXAM

Final Exam: A Full-Length Practice National Exam

Covers Units 1–10. Time: 150 minutes.

This is the course's full-length practice national exam: 100 four-choice questions mixed across all ten units. It mirrors the topics and weighting of the national portion of a salesperson licensing exam, following PSI's 2023 national outline — contracts, agency and the practice of real estate carry the most questions, with real estate math woven through. Take it the way a testing company gives it: closed book, no notes, basic calculator only, in one sitting with a 150-minute limit and a parent or proctor keeping time. Pace yourself at about a minute and a half per question, flag the hard ones and keep moving. Choose the one BEST answer, and answer every question — there is no penalty for guessing. Each question is worth one point. Seventy correct out of 100 (70%) matches the common passing line; Oregon requires 75% on each portion, so make 75 your own target. The real licensing exam also has a state portion on your state's license law, which this course does not cover in full — prepare for it from your state commission's website and the candidate handbook. Figures marked "in this example" are examples, not current rates, fees or limits. When you finish, review every miss in your exam notebook — why the right answer is right and why your choice was wrong — and file the scored exam in your Pathway File.

---

1. **1 pt** **Lesson 10.3**

   Under federal tax law, a retail store building held for investment is depreciated straight-line over:

   A. 27.5 years

   B. 15 years

   C. It is not depreciable

   D. 39 years

2. **1 pt** **Lesson 7.5**

   In a triple net (NNN) lease, the tenant pays rent plus:

   A. Property taxes only

   B. Property taxes and insurance only

   C. Property taxes, insurance and maintenance

   D. A percentage of gross sales over a breakpoint

3. 1 pt **Lesson 3.2**

The document a building department issues after a new structure passes inspection, certifying that it may lawfully be used, is a:

A. Certificate of occupancy

B. Building permit

C. Variance

D. Conditional use permit

4. 1 pt **Lesson 7.1**

A seller signs a purchase agreement only after the buyer threatens to harm the seller's family if he refuses. The contract is:

A. Void from the start

B. Voidable by the seller

C. Voidable by either party

D. Valid and enforceable

5. 1 pt **Lesson 8.4**

A licensee should disclose to a prospective buyer whom the licensee represents:

A. When the buyer is ready to write an offer

B. At closing, on the final settlement statement

C. Only if and when the buyer asks about it directly

D. At first substantive contact, before confidences

6. 1 pt **Lesson 7.1**

A signed purchase agreement says the refrigerator stays. After closing, the buyer claims the seller promised orally, before signing, to leave the washer and dryer too. Under the parol evidence rule:

A. The oral promise controls because it was made first

B. The oral promise generally cannot add to the written terms

C. The oral promise is enforceable if both agents heard it made

D. The whole contract is void because it was incomplete

7. 1 pt **Lesson 8.1**

A woman holds her father's durable power of attorney. He becomes incapacitated and, months later, dies. Her authority:

A. Survives his incapacity but ends at his death

B. Ends as soon as he becomes incapacitated

C. Survives his death until probate closes

D. Continues until she chooses to resign

8. 1 pt **Lesson 7.3**

A seller signs the buyer's offer but changes the possession date from June 1 to June 10 before returning it. Which is correct?

A. A contract binding both parties on the June 1 terms

B. A contract binding both parties on the June 10 terms

C. No contract; the seller has made a counteroffer

D. A contract, because the change was minor and unimportant

9. 1 pt **Lesson 9.4**

Errors and omissions insurance generally covers a licensee against:

A. Claims arising from intentional fraud

B. Injuries to visitors at an open house

C. Claims of negligent professional mistakes

D. Trust account shortages from conversion

10. 1 pt **Lesson 7.2**

Which arrangement substitutes a new party by agreement of everyone involved and releases the original party completely?

A. Assignment

B. Sublease

C. Ratification

D. Novation

11. (1 pt) **Lesson 7.4**

A family leases a house for two years and agrees in writing that they will buy it for $340,000 when the lease ends. This arrangement is a:

A. Lease-option, which lets the family walk away at the end

B. Lease-purchase, binding both parties to the sale

C. Right of first refusal on the house

D. Installment contract for deed

12. (1 pt) **Lesson 5.2**

A buyer purchases a home for $425,000 that appraised at $430,000, borrowing 90% of value, and pays 1.5 discount points. The points cost:

A. $5,737.50

B. $5,805.00

C. $6,375.00

D. $6,450.00

13. (1 pt) **Lesson 8.2**

From memory and without checking, a listing agent tells a buyer the roof is “about eight years old.” It is actually 22. The buyer relies on the statement. This is BEST described as:

A. Puffing

B. Negligent misrepresentation

C. Fraudulent misrepresentation

D. A patent defect

14. (1 pt) **Lesson 9.3**

A broker pays the office rent from the trust account, planning to repay it when a commission closes next week. This is:

A. Commingling

B. Interpleader

C. Conversion

D. Reconciliation

15. 1 pt **Lesson 9.1**

Under the federal Fair Housing Act, familial status protects:

A. Households with a child under 18, and pregnant women

B. Married couples, whether or not they have children

C. Any household with a resident 55 or older

D. Unmarried adults who share a home as roommates

16. 1 pt **Lesson 5.1**

When a loan secured by a deed of trust is paid in full, the title is cleared by:

A. A satisfaction signed by the borrower

B. A quitclaim deed from the county recorder

C. A novation signed by the beneficiary

D. A deed of reconveyance from the trustee

17. 1 pt **Lesson 6.5**

On a closing statement, which item is a credit to the buyer only?

A. The purchase price

B. The seller's loan payoff

C. The buyer's earnest money deposit

D. The real estate commission

18. 1 pt **Lesson 7.1**

Under the Statute of Frauds as most states apply it, which of these must be in writing to be enforceable?

A. A month-to-month rental agreement

B. A lease for a term of two years

C. A lease for a term of nine months

D. A tenancy at will between relatives

19. 1 pt **Lesson 7.4**

In an installment land contract, the buyer's greatest risk is:

A. Personal liability for the seller's other debts

B. Losing the deed the buyer received when the contract was signed

C. Automatic acceleration if the seller dies

D. Forfeiture of payments and possession after a default

20. 1 pt **Lesson 9.3**

At a lunch, several competing brokers agree that none of them will take a listing for less than 5%. Which is correct?

A. It is price fixing, illegal per se whatever the rate

B. It is lawful if the agreed rate is reasonable

C. It is lawful unless a seller files a complaint

D. It is illegal only if the MLS publishes the rate

21. 1 pt **Lesson 4.4**

A 1920s house was completely renovated and now has an effective age of 15 years. Using the age-life method, an appraiser bases depreciation on:

A. The actual age, which is a recorded fact

B. The age of the land under the house

C. The 27.5-year tax recovery period

D. The effective age, which reflects condition

22. 1 pt **Lesson 1.3**

A boundary line runs S 25° E from corner A to corner B. Its bearing from corner B back to corner A is:

A. N 25° E

B. S 25° W

C. N 25° W

D. N 65° W

23. 1 pt **Lesson 4.5**

A gross income multiplier, rather than a gross rent multiplier, is generally used for:

A. One-to-four-unit homes, with monthly rent

B. Commercial and larger properties, with annual income

C. Vacant land, with its assessed value

D. Special-purpose buildings such as churches, with cost new

24. 1 pt **Lesson 9.5**

When a property owner buys an insurance policy against a risk, which risk-management strategy is being used?

A. Transferring the risk

B. Avoiding the risk

C. Controlling the risk

D. Retaining the risk

25. 1 pt **Lesson 8.1**

For years an owner lets his brother tell buyers that the brother handles the owner's rental houses, and a buyer reasonably relies on the brother's promises. The owner may be bound under:

A. Agency coupled with an interest

B. Express agency

C. Ratification

D. Agency by estoppel

26. 1 pt **Lesson 8.3**

An owner gives open listings to three brokers. Broker B's efforts produce the buyer who purchases the property. Which is correct?

A. All three brokers share one commission

B. Only Broker B is owed a commission

C. Each broker is owed a full commission

D. No one is owed, since the listings were open

27. 1 pt **Lesson 3.1**

Besides governments, eminent domain may be exercised by:

A. Utilities and railroads, where a statute grants the power

B. Any developer who holds a building permit

C. Homeowners' associations enforcing their recorded CC&Rs

D. Title insurers clearing a cloud on title

28. 1 pt **Lesson 4.4**

In the cost approach, the land is:

A. Depreciated at the building's rate

B. Included in the building's cost new

C. Valued separately and never depreciated

D. Valued by capitalizing its rent

29. 1 pt **Lesson 7.5**

A tenant is two months behind on rent. Without going to court, the landlord changes the locks and puts the tenant's belongings on the curb. In most states the landlord:

A. Has lawfully carried out a constructive eviction

B. Has committed an illegal self-help eviction

C. Has acted within the covenant of quiet enjoyment

D. May do this after giving three days' notice

30. 1 pt **Lesson 9.1**

Which two protected classes were added to the federal Fair Housing Act by the amendments of 1988?

A. Sex and religion

B. Color and national origin

C. Handicap and familial status

D. Age and marital status

31. 1 pt **Lesson 8.5**

A house is sold "as is." After closing, the buyer discovers termite damage that the seller knew about and had hidden behind new paneling. The "as is" clause:

A. Does not shield the seller's concealment

B. Bars every claim the buyer might bring

C. Protects the seller because the buyer had an inspection

D. Shifts all liability to the listing agent

32. (1 pt) **Lesson 6.1**

A lender's ad says only, "Buy with just 5% down!" Under Regulation Z, the ad must also state:

A. Nothing more, since a down payment is not a credit term

B. Only the lender's name and its license number

C. The property tax rate and the insurance premium

D. The terms of repayment and the annual percentage rate

33. (1 pt) **Lesson 7.4**

A developer holds a one-year option to buy a parcel and wants protection if the owner sells to someone else during the year. The developer should:

A. Keep the signed option private and unrecorded

B. Record the option or a memorandum of it

C. Ask the owner to substitute a right of first refusal

D. Pay additional option money every month

34. (1 pt) **Lesson 5.2**

Which two parts of PITI does a servicer usually collect each month into an escrow (impound) account?

A. Principal and interest

B. Interest and insurance

C. Principal and property taxes

D. Property taxes and insurance

35. (1 pt) **Lesson 8.3**

A broker produces a qualified buyer who signs a full-price offer on the listing's exact terms, but the seller refuses to sign. Under the traditional rule, the broker:

A. Has earned the fee unless the listing says otherwise

B. Has earned nothing, because no sale ever closed

C. Has earned half the commission as a fee

D. Must collect the commission from the buyer at closing instead

36. (1 pt) **Lesson 2.3**

Kim and Lee own a cabin as joint tenants. Kim sells her interest to Max. Which is correct?

A. Max and Lee are joint tenants

B. Max holds only a life estate

C. Max and Lee are tenants in common

D. The sale is void without Lee's consent

37. (1 pt) **Lesson 7.2**

Which way of resolving a contract dispute usually produces a binding decision with very limited appeal?

A. Mediation

B. Rescission

C. Arbitration

D. Tender

38. (1 pt) **Lesson 3.4**

Under a common tax-sale pattern, an owner whose delinquent taxes were sold as a tax lien certificate can keep the property by:

A. Paying the original taxes after the period ends

B. Redeeming — paying taxes, interest and costs in time

C. Recording a quitclaim deed to the county treasurer

D. Filing a lis pendens against the certificate holder

39. (1 pt) **Lesson 8.5**

A buyer asks a listing agent whether the previous owner, who has since moved away, had AIDS. The agent should:

A. Decline to answer; HIV and AIDS are protected disabilities

B. Answer truthfully, since it is a material fact about the home

C. Answer only with the seller's written permission

D. Refer the buyer to the former owner's doctor

40. 1 pt **Lesson 7.3**

A buyer asks her agent to write a custom clause making the purchase contingent on the city approving a lot split, with detailed conditions and deadlines. The agent should:

A. Draft the clause carefully and have both parties initial each page

B. Write the clause and add “consult an attorney” at the end

C. Refuse, because such contingencies are not allowed

D. Use an approved form if one fits; refer the rest to an attorney

41. 1 pt **Lesson 6.5**

In this example, the seller has already paid the full calendar year’s property taxes of $5,040. Closing is September 20, the seller is charged through the day of closing, and a 360-day year is used. The tax proration is:

A. $1,400, debit seller and credit buyer

B. $3,640, debit buyer and credit seller

C. $1,408.44, debit buyer and credit seller

D. $1,400, debit buyer and credit seller

42. 1 pt **Lesson 5.3**

A loan program that commonly requires no down payment from moderate-income buyers in eligible rural areas is the:

A. USDA Rural Development guaranteed loan

B. FHA-insured loan

C. Conforming conventional loan

D. Home Equity Conversion Mortgage

43. 1 pt **Lesson 10.5**

A national exam has 80 scored questions and 5 unscored pretest questions that look exactly like the others. The best strategy is to:

A. Skip any question that looks new or experimental

B. Answer every question carefully, as if it counts

C. Rush the last five, since those are the pretest items

D. Leave the hard questions blank to avoid any penalty

44. (1 pt) **Lesson 2.2**

A tenant with two years left on a written lease for a fixed term dies. The lease:

A. Ends at once by operation of law

B. Becomes a tenancy at will either side may end

C. Continues and binds the tenant’s estate

D. Becomes a month-to-month periodic tenancy

45. (1 pt) **Lesson 2.4**

A buyer acquires a contractual right to use a resort unit one week each year for 20 years, with no ownership interest in the unit. She holds:

A. A timeshare use, which is personal property

B. A timeshare estate, which is real property

C. A condominium unit in fee simple

D. A proprietary lease in a cooperative

46. (1 pt) **Lesson 3.4**

In this example, a home’s assessed value is $280,000. The state applies an equalization factor of 1.10 to the county’s assessments, and the tax rate is $2.50 per $100 of equalized value. The annual tax is:

A. $770

B. $6,300

C. $7,000

D. $7,700

47. (1 pt) **Lesson 9.4**

An agent finds a for-sale-by-owner seller whose number is on the National Do Not Call Registry. She has no prior relationship and no written permission. May she call to ask for the listing?

A. Yes; by-owner sellers are exempt from the registry

B. Yes, if she calls between 8 a.m. and 9 p.m.

C. No; soliciting the listing is a telemarketing call

D. Yes, if she dials by hand rather than by machine

48. (1 pt) **Lesson 6.2**

Under the TRID rule, which charge is in the zero-tolerance category and may not increase at all from the Loan Estimate?

A. The homeowners insurance premium

B. The lender's origination fee

C. Recording fees and lender-listed title services

D. Prepaid interest

49. (1 pt) **Lesson 2.5**

A power company holds a recorded right to run lines across the back of every lot in a subdivision. This right is:

A. An easement appurtenant

B. An easement in gross

C. A revocable license

D. A recorded encroachment

50. (1 pt) **Lesson 5.5**

In a state with a one-year statutory redemption period, a buyer at a sheriff's sale immediately starts an expensive remodel. The main risk is that:

A. The former owner redeems within the year and takes it back

B. The lender cancels the sale for any reason it chooses

C. The buyer's title is void until the remodel is entirely finished

D. All junior liens revive once the remodel begins

51. (1 pt) **Lesson 10.4**

As of 2026, Washington and Oregon both call their entry-level real estate license a:

A. Salesperson license

B. Associate license

C. Broker license

D. Principal broker license

52. 1 pt **Lesson 4.1**

A vacant lot is zoned for offices and homes. A gas station would earn the most money there but is not allowed. Which test of highest and best use eliminates the gas station?

A. Physically possible

B. Financially feasible

C. Maximally productive

D. Legally permissible

53. 1 pt **Lesson 8.4**

In a transaction-broker (facilitator) relationship, where state law allows it, the licensee:

A. Represents both parties with full loyalty to each

B. Helps one or both parties without representing either

C. Represents the seller as a subagent of the listing firm

D. Owes full advocacy and confidentiality to the buyer

54. 1 pt **Lesson 1.5**

A cabin sits beside a non-navigable creek in an eastern state that follows riparian rights. The cabin owner generally owns the land:

A. To the center (thread) of the creek

B. Only to the water’s edge

C. To the far bank of the creek

D. Only to the average high-water mark

55. 1 pt **Lesson 4.3**

In this example, the subject has 2,000 square feet and two baths. A comparable that sold last month for $440,000 has 2,150 square feet and one bath. The market supports $80 per square foot and $9,000 per bath. The comparable’s adjusted price is:

A. $419,000

B. $437,000

C. $443,000

D. $461,000

56. 1 pt **Lesson 7.3**

A seller accepts an offer contingent on the sale of the buyer's home, keeps marketing, and gives the buyer 72 hours to remove the contingency if a better offer arrives. This provision is a:

A. Protection (carryover) clause

B. Liquidated damages clause

C. Kick-out (escape) clause

D. Right of first refusal

57. 1 pt **Lesson 1.1**

When buyer and seller have no written agreement about an item, which fixture test do courts usually treat as the most important?

A. The method by which it was attached to the house

B. The price paid for the item

C. The relationship of the parties

D. The intention of the person who attached it

58. 1 pt **Lesson 8.5**

A defect that would not be revealed by an ordinary, reasonable inspection is a:

A. Patent defect

B. Curable defect

C. Disclosed defect

D. Latent defect

59. 1 pt **Lesson 6.4**

A buyer never visits a rental house before buying it. A tenant there holds an unrecorded three-year lease. The buyer:

A. Takes subject to it, since possession gives notice

B. Takes free of the lease, since it was never recorded

C. May end the lease by giving 30 days' notice

D. Is bound only if he had actual notice of the lease

60. (1 pt) **Lesson 8.3**

At a listing appointment, an agent tells a seller, “Every company in town charges the same rate; it’s the standard.” This statement:

A. Is accurate if the MLS publishes the rate

B. Is a disclosure required by license law

C. Misleads the seller and suggests price fixing

D. Is acceptable if the rate is reasonable

61. (1 pt) **Lesson 7.3**

A house burns down before closing through no one’s fault. The contract is silent, the state follows the Uniform Vendor and Purchaser Risk Act pattern, and the buyer has not taken possession. The loss falls on:

A. The buyer, as the holder of equitable title

B. The buyer and seller equally, by law

C. The listing broker’s errors and omissions insurance carrier

D. The seller; the buyer may cancel and recover the deposit

62. (1 pt) **Lesson 10.2**

In this example, a home sells for $520,000 at a 5% commission. The listing brokerage keeps 55% of the commission and pays 45% to the cooperating brokerage, and the listing agent receives 70% of her firm’s share. What does the listing agent earn?

A. $8,190

B. $10,010

C. $14,300

D. $18,200

63. (1 pt) **Lesson 5.4**

A loan’s payments are figured as if over 30 years, but the remaining balance is due in full after 7 years. The large final payment is called a:

A. Balloon payment

B. Negative amortization

C. Prepayment penalty

D. Acceleration

64. (1 pt) **Lesson 3.3**

A deed conveys land “to the grantee, provided that if the premises are ever used for any commercial business, the grantor may re-enter and reclaim title.” A later owner opens a shop. The grantor’s remedy is:

A. Only an injunction closing the business

B. Only money damages, paid to the neighboring owners

C. Forfeiture of the owner’s title through re-entry

D. Escheat of the land to the county

65. (1 pt) **Lesson 9.1**

An owner lives in one unit of her triplex and rents the other two herself, without a broker. Her online ad reads “Adults only.” Which is correct?

A. The ad is illegal; the ad ban binds even exempt owners

B. The ad is legal under the “Mrs. Murphy” owner-occupant exemption

C. The ad is legal so long as she uses no broker

D. The ad is illegal only if it mentions race

66. (1 pt) **Lesson 9.2**

A landlord with a large one-bedroom apartment turns away a married couple expecting a baby, citing a firm “two people maximum” rule. The policy MOST likely:

A. Is lawful, since federal law caps two people per bedroom

B. Is lawful, since the baby has not yet been born

C. Violates only the Americans with Disabilities Act

D. Discriminates on familial status as an unreasonable rule

67. (1 pt) **Lesson 10.3**

In this example, an apartment building sold for $1,250,000. Its effective gross income was $150,000, its operating expenses were $62,500 and the owner’s annual debt service was $70,000. What capitalization rate does the sale indicate?

A. 1.4%

B. 5.0%

C. 7.0%

D. 12.0%

68. (1 pt) **Lesson 6.3**

A will leaves a farm to a nephew and a coin collection to a niece. The gift of the farm is a ___, and the nephew is the ___.

A. Bequest; legatee

B. Devise; devisee

C. Legacy; legatee

D. Devise; executor

69. (1 pt) **Lesson 4.2**

Under the Equal Credit Opportunity Act's valuation rule, a lender making a first-lien loan on a dwelling must:

A. Let the applicant choose and pay the appraiser

B. Give the applicant a free copy of each appraisal

C. Provide a copy of the appraisal only if the loan is denied

D. Charge the applicant the cost of each copy

70. (1 pt) **Lesson 1.4**

Why does the rectangular survey run standard parallels (correction lines) every 24 miles north and south of the base line?

A. To mark the boundary of each county

B. To separate sections from government lots

C. To measure elevation above sea level

D. To correct for meridians converging toward the pole

71. (1 pt) **Lesson 8.2**

A buyer tells the listing agent, "I'd pay full price, but let's start lower." The listing agent:

A. Must keep it confidential, since the buyer said it to her privately

B. May tell the seller only with the buyer's written consent

C. Must tell the seller, because disclosure is owed to the client

D. Should ignore it, because it is merely negotiating talk

72. 1 pt **Lesson 4.2**

Before approving a short sale, a bank asks a real estate licensee for a quick estimate of the property's probable selling price. Where state law allows, the licensee prepares a:

A. Broker price opinion

B. USPAP appraisal

C. Automated valuation model

D. Certificate of reasonable value

73. 1 pt **Lesson 8.2**

Which fiduciary duty requires a broker to keep earnest money in a trust account and to account for every dollar entrusted to him?

A. Accounting

B. Obedience

C. Loyalty

D. Confidentiality

74. 1 pt **Lesson 9.1**

A buyer asks to see homes in a price range and close to his job. The agent shows him homes only in neighborhoods where many residents share the buyer's national origin. This is:

A. Blockbusting

B. Steering

C. Redlining

D. Panic peddling

75. 1 pt **Lesson 7.3**

A purchase agreement includes a financing contingency written for the buyer's protection. It may be waived by:

A. The seller, after the appraisal

B. Either agent, with the broker's consent

C. The buyer, the party it protects

D. The lender, once the loan is approved

76. (1 pt) **Lesson 7.5**

A transaction in which a business sells its building to an investor and immediately leases it back is a:

A. Ground lease

B. Lease-option

C. Graduated lease

D. Sale-leaseback

77. (1 pt) **Lesson 1.2**

An owner leases her house to a family for one year. Which right in the bundle of rights passes to the tenants for the term?

A. Disposition, while the owner keeps possession

B. Disposition and possession, both together

C. None, because a lease is only a contract

D. Possession, while the owner keeps disposition

78. (1 pt) **Lesson 9.2**

A rental application asks every applicant, “Do you have any disabilities we should know about?” The question is:

A. Permitted, because every applicant is asked

B. Prohibited, even though it is asked of everyone

C. Required, so the landlord can plan accommodations

D. Permitted, but only for ground-floor units

79. (1 pt) **Lesson 10.1**

In this example, a lot is a rectangle 240 feet by 363 feet, with a triangle attached along one 363-foot side. The triangle’s base is that side, and its height is 120 feet. How many acres does the whole lot contain?

A. 2.0 acres

B. 2.25 acres

C. 2.5 acres

D. 3.0 acres

80. (1 pt) **Lesson 3.5**

A home inspector finds intact, non-crumbling asbestos wrap on the basement pipes of a 1940s house. The listing agent should:

A. Disclose it and recommend a qualified asbestos professional

B. Tell buyers that all asbestos must be removed before closing

C. Remove the wrap herself so the pipes can be inspected

D. Tell buyers that intact asbestos never needs attention

81. (1 pt) **Lesson 7.1**

A contract that lacks a lawful object — for example, an agreement to sell a building for use as an illegal gambling operation — is:

A. Voidable

B. Unenforceable

C. Executory

D. Void

82. (1 pt) **Lesson 6.1**

The Truth in Lending Act and Regulation Z apply to:

A. Every loan secured by real estate, business loans included

B. Only loans made by federally chartered banks

C. Consumer credit for personal, family or household purposes

D. Only loans whose APR is higher than the note rate

83. (1 pt) **Lesson 8.2**

When a licensee buys property for her own account, license law commonly requires her to:

A. Disclose in writing her license and personal interest

B. Buy only through listings held by her own brokerage

C. Pay the listing agent a referral fee at the closing

D. Wait one full year after licensing before buying property

84. 1 pt Lesson 9.3

Requiring buyers of a developer's lots to list their finished homes with the developer's brokerage is:

A. Market allocation

B. A tie-in arrangement

C. Group boycotting

D. Price fixing

85. 1 pt Lesson 6.2

A brokerage owns 40% of a title company and refers its buyers there. Under RESPA, the arrangement is lawful only if the brokerage:

A. Requires its buyers to use that title company to keep fees low

B. Pays the referring agent a share of each title fee earned

C. Discloses it, doesn't require it and takes only an ownership return

D. Discloses a referral fee for each buyer on the Closing Disclosure form

86. 1 pt Lesson 4.1

The principle that value is created by the expectation of future benefits — the foundation of the income approach — is:

A. Anticipation

B. Substitution

C. Conformity

D. Contribution

87. 1 pt Lesson 4.3

Appraisers use paired-sales analysis to:

A. Weigh the comparables during reconciliation

B. Convert net income into an indication of value

C. Estimate the cost to build an exact replica

D. Measure what the market pays for one feature

88. 1 pt **Lesson 9.2**

A tenant whose disability makes walking difficult asks her landlord to assign her a parking space near her door in a lot that is otherwise first-come, first-served. This is a request for a:

A. Reasonable modification

B. Reasonable accommodation

C. Variance

D. Direct-threat exception

89. 1 pt **Lesson 8.4**

Under an exclusive-agency buyer agreement, a buyer finds a for-sale-by-owner house entirely on his own and buys it. The buyer owes his broker:

A. The full fee stated in the agreement

B. Half the fee stated in the agreement

C. Nothing, because he found the house himself

D. Whatever fee the local MLS suggests

90. 1 pt **Lesson 2.1**

A life tenant is required to:

A. Get the remainderman's consent before leasing

B. Pay the property taxes and avoid committing waste

C. Pay the remainderman a yearly rent

D. Sell her estate only to the remainderman

91. 1 pt **Lesson 6.3**

A bank sells a house it took back in foreclosure and will warrant title only against defects that arose while the bank owned it. The bank will MOST likely give a:

A. General warranty deed

B. Quitclaim deed

C. Sheriff's deed

D. Special warranty deed

92. 1 pt **Lesson 5.5**

A mortgage broker differs from a mortgage banker in that a mortgage broker:

A. Arranges loans for a fee but does not fund them

B. Funds loans with its own money and services them

C. Buys conforming loans on the secondary market

D. Sets the discount rate that banks pay

93. 1 pt **Lesson 8.3**

Under which type of listing is the broker owed a commission no matter who sells the property during the term — even the owner?

A. Exclusive-agency listing

B. Open listing

C. Net listing

D. Exclusive-right-to-sell listing

94. 1 pt **Lesson 6.4**

An extended-coverage title policy adds protection that a standard policy excepts, such as:

A. Unrecorded easements and rights of parties in possession

B. Liens the owner places on the property after the closing date

C. Zoning changes adopted after the policy date

D. Declines in the property's market value

95. 1 pt **Lesson 7.2**

A seller signs a purchase agreement and dies two weeks before closing. The buyer is ready to close. Generally:

A. The contract ends at the seller's death

B. The seller's estate must complete the sale

C. The buyer may recover only his earnest money

D. The heirs may void the contract if they wish

96. 1 pt Lesson 9.5

A building's vacancy rate is 12%, while comparable buildings nearby average 4%. The FIRST explanation a manager should investigate is that:

A. Rents may be set below the market

B. The building has too few units

C. Rents may be set above the market

D. Operating expenses are too low

97. 1 pt Lesson 3.5

The EPA recommends fixing a home when an indoor radon test shows a level of:

A. 1 picocurie per liter or more

B. 10 picocuries per liter or more

C. 4 picocuries per liter or more

D. 40 picocuries per liter or more

98. 1 pt Lesson 2.5

An easement appurtenant ends by merger when:

A. The servient owner sells the burdened parcel to a stranger

B. One owner acquires both the dominant and servient parcels

C. The dominant owner stops using it for a month

D. The servient owner records a lis pendens

99. 1 pt Lesson 3.2

A city council changes a neighborhood's zoning from multifamily to single-family only. This is an example of:

A. Spot zoning

B. A variance

C. A nonconforming use

D. Downzoning

100. 1 pt Lesson 8.1

A listing agreement is a contract between the seller and:

A. The brokerage

B. The salesperson who took the listing

C. The multiple listing service

D. The buyer's brokerage

ANSWER KEY

1. D. Nonresidential real property is recovered over 39 years; residential rental buildings use 27.5 years (A). Only the building is depreciated — never the land.
2. C. Single net adds taxes, double net adds taxes and insurance, and triple net adds taxes, insurance and maintenance. A percentage of sales (D) describes a percentage lease.
3. A. The certificate of occupancy comes after construction complies with the codes. A building permit (B) is issued before construction begins.
4. B. Duress makes a contract voidable at the option of the victim. Only the threatened seller may void it (C); the buyer cannot use his own wrongdoing to escape.
5. D. Disclosure comes early — at the first substantive contact and before confidential information is exchanged or an offer is written, in the form and timing the state requires. Waiting (A) lets a customer reveal his top price to an agent who owes him no confidentiality.
6. B. Once the parties sign a final written agreement, earlier or simultaneous oral statements generally cannot contradict or add to its terms, though they may clarify an ambiguity or prove fraud. That is why inclusions belong in the written contract.
7. A. A durable power of attorney survives the principal's incapacity — that is its purpose — but every power of attorney ends at death, when the estate's personal representative takes over. An ordinary, non-durable power would end at incapacity (B).
8. C. Acceptance must mirror the offer exactly; any change, even a date, is a counteroffer that rejects and terminates the original offer. The buyer may now accept or reject the seller's new terms.
9. C. E&O covers negligence — a misstated lot size, a missed deadline — but not fraud or intentional wrongdoing (A). A visitor's injury (B) falls under general liability insurance.
10. D. A novation substitutes a new party or contract and discharges the original obligor. After an assignment (A), the assignor remains secondarily liable.
11. B. In a lease-purchase the tenant has agreed to buy, so both parties are obligated, and failing to buy is a breach. A lease-option (A) gives the tenant the right, but not the duty, to buy.

12. A. Value for LTV is the lesser of price and appraisal, so the loan is $0.90 \times \$425{,}000 = \$382{,}500$, and the points are $0.015 \times \$382{,}500 = \$5{,}737.50$. C figures the points on the price, and B bases the loan on the higher appraisal.

13. B. A false statement of material fact made carelessly, by someone who should have known better, is negligent misrepresentation; had the agent known it was false, it would be intentional. Puffing (A) is exaggerated opinion, not a specific false fact like a roof's age.

14. C. Using trust money for the broker's own purposes is conversion, whatever the intent to repay — grounds for revocation and often a crime. Commingling (A) is mixing client funds with the broker's own.

15. A. Familial status covers one or more children under 18 living with a parent, legal custodian or designee, and it also protects a pregnant woman and a person securing custody of a child. Marital status (B) and age (C) are not among the seven federal classes.

16. D. At payoff the beneficiary (lender) asks the trustee to issue a deed of reconveyance, which is recorded to clear the title. A mortgage, by contrast, is released by a satisfaction from the lender — not from the borrower (A).

17. C. Earnest money the buyer already paid reduces what he must bring, so it is a credit to the buyer alone. The price (A) is a double entry — debit buyer, credit seller — and the payoff and commission (B, D) are debits to the seller.

18. B. Most states require a writing for a lease longer than one year; a lease of one year or less may usually be oral. A few states use a different period, so check yours.

19. D. The vendor keeps legal title until the contract is paid, so a defaulting vendee risks forfeiture of payments and possession, subject to whatever notice and cure protections state law provides. The vendee receives the deed only at the end (B).

20. A. An agreement among competitors on commission rates is price fixing, illegal per se under the Sherman Act — no defense of reasonableness is heard (B). Commissions are set by each firm and negotiated with each client.

21. D. Age-life depreciation uses effective age — the age the building appears given its condition and utility — and a thorough renovation makes it younger than its calendar age (A). The 27.5-year period (C) is tax cost recovery, not appraisal.

22. C. Reversing a line reverses both letters and keeps the angle, so S 25° E becomes N 25° W. A and B change only one letter, and D changes the angle, which never happens on a reversal.

23. B. The GIM divides price by annual gross income and serves commercial and larger income properties. The GRM (A) uses monthly rent and serves one-to-four-unit residential property.
24. A. Under ACTS — avoid, control, transfer, retain — buying insurance transfers the risk to the insurer. Retaining (D) is accepting small, predictable losses, as with a deductible.
25. D. When a principal's words or conduct lead a third party reasonably to believe someone is his agent, the principal cannot later deny the agency — estoppel, or ostensible agency. Ratification (C) is approving an unauthorized act after the fact.
26. B. In an open listing only the broker who is the procuring cause of the sale is paid, and only one commission is owed. Had the owner found the buyer himself, no broker would be paid.
27. A. Quasi-public entities such as utilities and railroads may condemn property for a public purpose when state law authorizes it, and they too must pay just compensation. Associations enforce CC&Rs by injunction (C), not by taking title.
28. C. Value equals land plus cost new minus accrued depreciation. Land is valued separately, usually by comparing land sales, and is never depreciated (A) because it does not wear out.
29. B. Removing a tenant requires the court process — notice, a lawsuit, a judgment and removal by the sheriff. Constructive eviction (A) is the tenant's remedy when the landlord makes the premises unusable, and a lockout breaches quiet enjoyment (C).
30. C. Race, color, religion and national origin date from 1968; sex was added in 1974; handicap and familial status were added in 1988. Age and marital status (D) are not federal fair-housing classes.
31. A. "As is" means the buyer accepts conditions he can see or discover; it never shields active concealment or fraud about a known latent defect. The seller remains liable, and the buyer may seek rescission or damages.
32. D. The amount or percentage of a down payment is a triggering term, so the ad must also disclose the down payment, the terms of repayment (including any balloon) and the "annual percentage rate," noting if it may increase. A is the trap: a down payment is one of the four triggers.
33. B. Recording the option, or a memorandum of option, gives constructive notice to anyone who later buys from or lends to the optionor. A right of first refusal (C) would give him less — no fixed price and no power to force a sale.

34. D. The servicer collects one-twelfth of the annual property taxes and homeowners insurance each month and pays those bills when they come due. Principal and interest (A) go to the lender to repay the loan.

35. A. Producing a ready, willing and able buyer on the listing's terms traditionally earns the commission even if the seller refuses to sell, though many listings make it payable only at closing — the listing's own wording controls.

36. C. A joint tenant may sell his interest, but the buyer acquires at a different time and by a different deed, breaking the unities of time and title. Max becomes a tenant in common with Lee, and with only two owners no joint tenancy remains (A).

37. C. An arbitrator hears the dispute and decides it, and the decision is usually binding — so an arbitration clause generally gives up a jury trial on that dispute. A mediator (A) only helps the parties reach their own settlement.

38. B. The owner may redeem by paying the delinquent taxes, interest and costs within the period state law allows; if no one redeems, the certificate holder may seek a tax deed. Paying after the period ends (A) comes too late.

39. A. Under the federal Fair Housing Act, HIV and AIDS are treated as disabilities, so a licensee should not volunteer or answer whether an occupant had either. It is not a material fact about the property (B).

40. D. Licensees may fill in the blanks on approved forms but may not draft legal clauses or explain their legal effect; doing so is the unauthorized practice of law. Adding a disclaimer (B) does not cure drafting the clause.

41. D. Monthly $\$5{,}040 \div 12 = \$420$; daily $\$420 \div 30 = \$14$. The buyer owns September 21–30 (10 days) and three full months: $3 \times \$420 + 10 \times \$14 = \$1{,}400$. The seller prepaid days the buyer will own, so debit the buyer and credit the seller. A reverses the entry, B is the seller's own share, and C uses a 365-day year.

42. A. USDA Rural Development guarantees loans for moderate-income families in eligible rural areas, commonly with no down payment. FHA (B) requires a small down payment, and a HECM (D) is a reverse mortgage for owners 62 or older.

43. B. You cannot tell which items are pretest items, so treat every question as scored — and never leave a blank, because there is no penalty for guessing (D).

44. C. An estate for years is not ended by the death of either party; the lease binds the tenant's estate and heirs for the remaining term unless it says otherwise. Only an estate at will ends at a party's death (B).

45. A. A right to occupy for set periods over a number of years, with no ownership, is a timeshare use — a personal-property interest like a lease or license. A

timeshare estate (B) conveys a fee interest in the interval by deed.

46. D. Equalized value: $\$280{,}000 \times 1.10 = \$308{,}000$. Tax: $3{,}080 \times \$2.50 = \$7{,}700$. C ignores the equalization factor, A reads the rate as per $1,000, and B lowers the value by 10% instead of raising it.

47. C. Asking an owner to hire you is a solicitation — telemarketing — so a registered number may not be called without an established business relationship or written permission. Calling hours (B) limit lawful calls; they do not make this one lawful.

48. B. Charges paid to the lender or broker, such as origination fees and points, have zero tolerance. Recording fees and lender-listed services (C) share a 10% aggregate tolerance, while insurance premiums and prepaid interest (A, D) need only be estimated in good faith.

49. B. An easement that benefits a person or company rather than a neighboring parcel is an easement in gross; there is no dominant tenement. An easement appurtenant (A) requires a dominant parcel that benefits, and a license (C) is personal permission, not an interest in land.

50. A. Where a statute grants it, the former owner may buy the property back within the redemption period by paying the sale price plus interest and allowed costs — and the buyer's improvements would then benefit the owner. Buyers commonly wait out the period before investing heavily.

51. C. Washington's Department of Licensing and the Oregon Real Estate Agency both call the entry license "broker," while Idaho, Montana and Alaska use "salesperson" (A). Always confirm with your own state's agency.

52. D. The tests run in order — legally permissible, physically possible, financially feasible, maximally productive — and a use the zoning forbids fails the first. Its high earnings would matter only at the last test (C), which it never reaches.

53. B. A transaction broker assists without acting as anyone's agent, owing the duties the state lists — commonly honesty, reasonable care, accounting and disclosure of known defects — but not loyalty or advocacy. No one can give full loyalty to both sides (A).

54. A. Along a non-navigable stream the riparian owner generally owns to the center, or thread. Along a navigable river (B) the owner generally owns only to the water's edge, and the average high-water mark (D) is the usual littoral boundary on lakes and seas.

55. B. The comparable is 150 square feet larger (better), so subtract $150 \times \$80 = \$12{,}000$; it has one fewer bath (worse), so add $9,000: $\$440{,}000 - \$12{,}000 +$

$9,000 = $437,000. C reverses both directions — remember, comp better, subtract; comp worse, add.

56. C. A kick-out clause lets a seller who accepted a contingent offer keep marketing and require the buyer to remove the contingency or step aside. A protection clause (A) belongs to listing agreements.

57. D. Absent an agreement, intention — judged objectively from the item's nature, attachment and purpose — is usually the most important test. Method of attachment (A) is only evidence of intention, and a written agreement, when there is one, overrides every test.

58. D. A latent defect is hidden — a cracked slab under carpet, a buried tank — and a known latent material defect must be disclosed. A patent defect (A) is visible on reasonable inspection.

59. A. A buyer is charged with what an inspection would reveal, including the rights of anyone in possession, whether or not he looked. An unrecorded lease (B) still binds a buyer when the tenant is in possession.

60. C. There is no standard commission: each firm sets its own fees, and every commission is negotiable between broker and client. Implying a uniform rate suggests an agreement among competitors, which antitrust law forbids — and as of 2026, offers of compensation are not even published on the MLS (A).

61. D. Under the Act's pattern, risk stays with the seller until the buyer takes possession or legal title. The traditional rule put it on the buyer as holder of equitable title (A), which is why most contracts now allocate the risk expressly.

62. B. Total: $\$520{,}000 \times 0.05 = \$26{,}000$. Listing firm: $\$26{,}000 \times 0.55 = \$14{,}300$. Agent: $\$14{,}300 \times 0.70 = \$10{,}010$. D takes 70% of the whole commission, and C is the firm's share. Every rate here is an example; commissions are negotiable.

63. A. A partially amortized loan leaves a balance due at the end — a balloon. Negative amortization (B) is a rising balance, and acceleration (D) is the lender's remedy on default.

64. C. This is a condition, not a mere covenant: breach lets the grantor or heirs end the estate and reclaim title. Injunctions and damages (A, B) are the remedies for a covenant, which is why courts read unclear language as a covenant — but this wording is clear.

65. A. Even where the Mrs. Murphy exemption covers an owner's rentals, the ban on discriminatory notices, statements and ads applies to everyone, exempt or not. "Adults only" states a preference against families with children.

66. D. HUD treats two persons per bedroom only as a general guideline, not a federal cap (A), adjusted for room size, children's ages and local codes, and a pregnant woman is protected under familial status. A rigid cap that turns away a couple with a newborn invites a complaint.

67. C. NOI: $\$150{,}000 - \$62{,}500 = \$87{,}500$. Rate: $\$87{,}500 \div \$1{,}250{,}000 = 0.07 = 7\%$. D divides gross income by the price, and A subtracts debt service, which belongs in cash flow, never in NOI.

68. B. A gift of real property by will is a devise to a devisee; a gift of personal property, like the coins, is a bequest or legacy to a legatee (A, C). The executor (D) carries out the will.

69. B. The lender must provide a free copy of all appraisals and written valuations promptly, and generally at least three business days before closing. The copy is free (D), and it is owed whether or not the loan is approved (C).

70. D. Meridians draw closer together as they run north, so townships would grow narrower; correction lines and guide meridians every 24 miles reset the measurements. Elevations (C) are measured from a datum through benchmarks.

71. C. The seller is the listing agent's client and is owed every material fact, including a buyer's willingness to pay more. The buyer is a customer and is owed honesty and fair dealing, not confidentiality (A).

72. A. A broker price opinion is a licensee's estimate of probable selling price, typically for a lender's loss-mitigation decision. It is not an appraisal (B), which only a state-licensed or certified appraiser may prepare, and an AVM (C) is a computer estimate.

73. A. Accounting is the duty to safeguard and account for all money and property entrusted to the agent — the duty broken by commingling or conversion.

74. B. Steering is channeling buyers toward or away from neighborhoods because of a protected class, even with friendly motives; the agent should show every home that meets the buyer's stated objective criteria. Blockbusting (A), also called panic peddling (D), targets owners, not buyers.

75. C. A contingency may be waived only by the party it protects. A buyer who waives the financing contingency must close even if his loan later falls through.

76. D. A sale-leaseback turns the value locked in a building into working capital while the business keeps possession. A ground lease (A) rents land on which the tenant builds.

77. D. A lease hands over possession (with use and enjoyment) for the term, while the owner keeps disposition — she may still sell, mortgage or will the property,

subject to the lease. A reverses the two.

78. B. An owner may not ask applicants whether they have a disability or about its nature or severity. Only when a resident requests an accommodation and the need is not obvious may the owner ask for reliable information about the disability-related need.

79. C. Rectangle: $240 \times 363 = 87{,}120$ square feet. Triangle: $\frac{1}{2} \times 363 \times 120 = 21{,}780$ square feet. Total: $108{,}900 \div 43{,}560 = 2.5$ acres. D forgets the ½ in the triangle formula, and A leaves the triangle out.

80. A. Asbestos is dangerous mainly when friable; intact material is often managed in place by encapsulation. A licensee discloses what is known and refers buyers to qualified professionals — never diagnosing, disturbing or removing it (C).

81. D. An agreement missing an essential element — here a lawful object — is void, with no legal effect from the start. Voidable (A) describes a valid contract one protected party may cancel, and unenforceable (B) describes a valid contract a court will not enforce.

82. C. TILA covers consumer credit; credit primarily for business, commercial or agricultural purposes is exempt, so a loan to buy an office building for a business is not covered (A).

83. A. A licensee buying or selling for herself, a relative or her own business must disclose in writing that she is licensed and has a personal interest. Undisclosed self-dealing is a classic breach of loyalty.

84. B. A tie-in conditions the sale of one product (the lot) on the purchase of another service (the listing). Market allocation (A) divides territory, price ranges or customers among competitors.

85. C. An affiliated business arrangement is lawful only with a written disclosure at or before the referral, no required use, and no payment beyond a return on ownership. Paying for referrals (B, D) is a Section 8 kickback even when it is disclosed.

86. A. Anticipation: value is the present worth of expected future benefits, which is why the income approach capitalizes future income and why a planned rail station can raise nearby prices before it opens.

87. D. Two sales alike in every way but one show, by their price difference, what the market pays for that one feature — the source of adjustment values. Converting income into value (B) is capitalization.

88. B. A change in a rule, policy or service is a reasonable accommodation, and assigning a space generally must be granted. A reasonable modification (A) is a

physical change to the premises, such as a ramp or grab bars.

89. C. In an exclusive-agency buyer agreement the broker is the buyer's only agent, but the buyer owes nothing for a property he finds entirely by himself. Under an exclusive buyer agency agreement he would owe the fee (A), and no MLS sets fees (D).

90. B. A life tenant enjoys real ownership while alive but must pay the taxes, keep the property in reasonable repair and not commit waste that harms the remainderman. She may lease or sell her life estate without consent (A, D), though whatever she conveys ends at the measuring life's death.

91. D. A special warranty deed warrants only against claims "by, through or under" the grantor during its own ownership — the usual deed from lenders, trustees and corporations. A general warranty deed (A) reaches back through the whole chain of title, and a quitclaim (B) warrants nothing.

92. A. A mortgage broker only brings borrower and lender together for a fee. A mortgage banker (B) originates and funds loans, usually sells them and often services them; buying loans (C) is what Fannie Mae and Freddie Mac do.

93. D. Under an exclusive right to sell, the broker earns the commission whoever sells during the term. Under an exclusive agency (A), an owner who sells on his own owes nothing, and under an open listing (B) only the procuring cause is paid.

94. A. Extended coverage adds the off-record risks a survey or inspection would reveal — unrecorded easements and liens, encroachments and rights of parties in possession. No title policy covers the owner's later acts (B), zoning (C) or market value (D).

95. B. A real estate sales contract binds the parties' estates and heirs, so the executor or administrator must complete the sale. Personal-service contracts, such as a listing agency, are the ones that end at death (A).

96. C. Vacancy well above the market suggests rents are too high, or that the property is poorly maintained or marketed, so a market survey of comparable units comes first. Vacancy far below the market (A), especially with a waiting list, suggests rents are too low.

97. C. The EPA action level is 4 pCi/L. Radon is colorless and odorless, so only a test reveals it, and it is commonly fixed with sub-slab depressurization.

98. B. No one can hold an easement over his own land, so when one owner acquires both parcels the easement merges and ends. A sale of the servient parcel (A) does not end it — an appurtenant easement runs with the land.

99. D. A rezoning to a less intensive use or lower density is downzoning. Spot zoning (A) singles out one parcel against the comprehensive plan for its owner's benefit, and apartments already built might continue afterward as nonconforming uses (C).

100. A. The client's contract is with the broker, and the salesperson acts for the broker. That is why a listing stays with the brokerage when a salesperson leaves the firm (B).