

CALIFORNIA REAL ESTATE PRACTICE





California Real Estate Practice

Robert Handwerker and Jerry Frankel

Copyright © 2021 License Solution

ALL RIGHTS RESERVED. No part of this book covered by the copyright herein may be reproduced or used in any form by any means, including but not limited to, photocopying, recording, graphic, online distribution or any other manner.

License Solution, Inc.

2700 Neilson Way, Suite 731

Santa Monica, CA

888-714-0566

Table of Contents

Chapter 1: California Trends and The Credit Crisis.....	5
Chapter 2: Agency Relationships and Career Opportunities.....	40
Chapter 3: Market Studies and New Connections.....	74
Chapter 4: Prospecting and Business Development.....	105
Chapter 5: Advertising.....	139
Chapter 6: Listings - Presentations and Types.....	176
Chapter 7: Listings - Contracts, Servicing, and Laws.....	210
Chapter 8: Showings, Preparing Offers, and Negotiating.....	242
Chapter 9: Financing Properties.....	277
Chapter 10: Credit and Mortgages.....	310
Chapter 11: Escrow, Title, and Taxation.....	347
Chapter 12: Leasing and Property Management.....	380
Glossary.....	418
Index.....	476

CHAPTER 1

CALIFORNIA TRENDS AND THE CREDIT CRISIS

Overview

Home prices in California have bounced back and forth between highs, lows, and back to near or all-time highs over the past 10 years. The real estate profession has also gone through several up and down cycles along with significant changes made to the real estate and mortgage professions such as updated disclosure and contract form requirements. This first chapter will cover home prices, demographics, and income trends that have become increasingly beneficial to many real estate professionals and investors in the state.

Agency and Housing Price Trends

According to the National Association of Realtors, there was a seasonally adjusted annual rate of 6.85 million housing units sold by the month of October 2020. The median price for the homes sold nationally reached \$313,000 by October 2020 as well. The new housing construction start numbers for 2019 reached 888,000. And in just the first three quarters of 2020, there were 714,000 new housing starts. This, compared to the first three quarters of 2019 (when there were 674,000 new home starts), is an increased rate of almost 6%.

California's median home price numbers are much higher in most regions of the state as compared with the national median price of \$313,000. Since real estate agents earn the bulk of their income from commission percentage rates that are based on the selling or lease prices for residential or commercial property sales, the opportunities for significant

amounts of income for agents in California should be much higher than just about any other state.

For example, the sale of just one home that is priced at \$1 million is likely to generate a 3% commission fee to both the buyer's agent and the listing agent. If so, the gross commission amount collected by each agent would be equal to \$30,000. Depending upon the mutually agreed upon broker split between the employing broker and his or her salesperson (i.e., 70% to the salesperson and 30% to the broker in a 70/30 split), the net income to each broker would still be close to \$21,000 per agent involved in the purchase deal. For agents who are fortunate to work on transactions like these in California on a consistent basis, the potential annual income levels can easily reach \$100,000 or more every year throughout their career.

Top California Housing Markets by List Price

Let's take a closer look below at some recent actual listing numbers for the top metropolitan regions in California as a way to show new and older experienced agents about the true growth opportunities for people who work in the real estate field. Over the past several years, home prices in the state have moved in a strong positive direction skyward as partly noted by the year-over-year (Y/Y) price differences for the strongest housing markets in the state from data also provided by the National Association of Realtors (NAR).

<u>Metropolitan Area</u>	<u>Median List Price</u>	<u>Y/Y Change</u>
Santa Maria / Santa Barbara	\$1,377,000	23.1%
San Jose / Sunnyvale	\$1,100,000	22.2%
Salinas	\$899,000	3.3%
San Francisco / Oakland	\$899,000	8.3%
Santa Rosa	\$729,000	4.1%
Oxnard / Thousand Oaks	\$700,000	0.0%

San Luis Obispo	\$700,000	2.0%
Los Angeles / Long Beach	\$699,900	3.7%
San Diego / Carlsbad	\$650,000	4.8%
Truckee / Grass Valley	\$549,900	0.2%
Ukiah	\$549,000	-0.9%
Sacramento / Roseville	\$440,000	4.8%
Vallejo / Fairfield	\$439,000	4.5%
Stockton / Lodi	\$384,100	8.2%
Riverside	\$369,900	5.7%
Modesto	\$334,400	6.2%
Madera	\$325,000	13.7%
Redding	\$324,000	9.8%
Fresno	\$300,000	13.2%
Yuba City	\$300,000	7.5%

Now, let's review the top counties in the state by median list price and year-over-year price changes (source: NAR):

<u>County Area</u>	<u>Median List Price</u>	<u>Y/Y Change</u>
San Francisco	\$1,295,000	8.4%
Santa Clara	\$1,198,000	27.5%
Orange	\$799,000	6.5%
Alameda	\$789,000	8.2%
Ventura	\$700,000	0.0%
Los Angeles	\$650,000	3.3%
San Diego	\$650,000	4.8%
Contra Costa	\$625,000	5.1%
Riverside	\$410,000	6.5%
Sacramento	\$375,000	11.0%
San Bernardino	\$329,000	6.4%
Fresno	\$300,000	13.2%

California has a wide range of residents and homes for sale that are priced from very affordable to some of the most expensive home prices in the nation and entire world. As a result, the median prices for the entire state give a much more realistic look at the latest price trends. Per the California Association of Realtors, the October 2017 numbers were as follows for the entire state as compared with the previous year's prices in 2016:

<u>Residential Unit Type</u>	<u>Median Price</u>	<u>Y/Y Price Change</u>
Single-Family Home	\$546,430	6.1%
Condos / Townhomes	\$450,840	7.4%

And since 2017, the prices have increased even further for both single-family homes and condos/townhomes. For single-family homes, the median price has increased to \$699,000 statewide as of November 2020, about a 28% increase since 2017. And for condos/townhomes, the median price has increased from 2017's \$450,840 to \$520,000 in 2020, an increase of 15% over the last three years.

California Agency Trends

As of 2017, there were an estimated 97,500 active real estate brokers and 195,500 active salespersons in the state of California. The number of active real estate brokers has slowly been declining across the state over the past decade. The number of real estate brokers in the state reached a near peak of approximately 109,500 active brokers in the state back in January 2010, and the numbers have fluctuated between then and 2020. (As of 2020, there are 93,795 brokers and 206,308 agents.)

Over the past several decades, the number of active agents to active brokers in California has hovered right around 1.5 agents for every one broker at a 1.50 ratio. At the peak of agents to brokers in the state about a decade ago, there were as many as 2.7 agents per active broker. Near

the absolute peak of the last housing bubble back near the official start of the Credit Crisis in the summer of 2007, the number of active salespersons in California reached as high as 261,000+ in October 2007.

As home prices began to fall and lenders started to tighten up their once easy mortgage underwriting guidelines, the number of both active salespersons and brokers fell in numbers as well, only to rebound in the last couple of years.

Over the past several decades, what was the average ratio of active salespersons to brokers in California?

Active and Inactive Agent Numbers

During the peak years of “fix-and-flip” deals in the the early-to mid first decade of the twenty-first century, it was easy to make incredibly high double-digit annual returns in less than a few months. Some property investors were making \$100,000 to \$500,000 plus per home bought, fixed up, and flipped (or quickly resold) to other investors or owner-occupants. Many of these same part-time or full-time investors decided to get their salesperson’s or broker’s license to collect commissions as both a buyer and seller on the multiple transactions involved with one or more properties. If the new agents who were also investors could collect \$200,000 in profit from the home purchase and subsequent resale, then they might also collect another \$20,000 to \$40,000 in commission fees using their real estate license, acting as both a principal and an agent in each side of the transaction.

In some parts of the state, the housing prices and buyer demand did not begin to noticeably decline until 2006, 2007, or 2008. As such, the numbers of people scrambling to pick up their real estate licenses in the state continued to grow up until the peak year of 2008 when the total combined number of “active” and “inactive” salesperson and broker

licensees (or anyone holding a license whether they actually worked in the real estate field or not) reached a mind boggling 542,267.

In many regions of the country, there are not very many cities or counties with population bases larger than 542,000 residents. Yet, California's 2008 licensee numbers reached well over half of a million just before the real estate and financial markets began to lose their upward momentum prior to moving in a negative direction. Just six years later in 2014, the number of all real estate licensees in the state fell from 542,000+ down to an estimated 403,942 licenses. As such, the number of all licensees in the state declined by almost 140,000 in just six years.

With each year between late 1998 (near 300,000 agents) and 2008, the number of real estate licensees in the state grew at an exponentially positive rate. The total number of new agents grew by well over 242,000 agents during this 10-year time span as the median prices for California homes rapidly grew and compounded as well. The increase of licensed real estate agents in the state that grew from 300,000 to just over 542,000 agents between 1998 and 2008 was a massive 80% increase. During this same period of time, the overall California population grew by only 15% by comparison.

Sales Numbers for Properties

Over the past 10 years or so, the number of real estate licensees have fallen right alongside mortgage rates as they reached historically low 30-year fixed mortgage rates near the 3% and 4% ranges. However, the number of housing units sold each month throughout the state has fallen as well, while median prices have headed to near all-time-record highs, ironically. As such, agents might be closing fewer home sales but at much higher sales prices and commission fees.

As far back as June 2005 when subprime and "EZ Doc" (no income verification) mortgage loans were quite popular with owner-occupants, investors, real estate agents, and mortgage brokers, the peak number of

monthly sales in California reached as high as 75,936. For the entire year of 2005, the total amount of home sales for the state was more than 754,000.

In April of 2014, the number of total statewide home sales was cut in half to 37,988. Even though mortgage interest rates were much lower in 2014 as compared with 2005, the number of home sales was half as many. The biggest difference between the lowest and highest month of closed individual housing unit sales statewide between 1998 and 2008 was a 45,000 drop from the best and worst month during this 10-year time span.

From a once peak monthly sales high of almost 76,000 home sales in June 2005, the monthly sales figures for the most recent years has fallen to almost 40% to 50% of these past peak monthly highs. In September 2017, for example, the total number of brand new and resale closed home transactions for the entire state reached approximately 39,000. This is almost half of June 2005's monthly closing.

For the entire year of 2016 statewide, there were an estimated 457,900 home sales. That was 7,200 more sales than in 2016, a 1.5% increase. Yet, the 2016 total sales number for the state was still almost 40% lower than the peak sales volume for 2005.

The sales numbers for the southern and northern portions of the state in 2016 and 2017 were broken down as follows for the month of September in each respective year:

Southern California:	21,000 (Sep. 2017); 21,200 (Sept. 2016)
Northern California:	18,000 (Sep. 2017); 18,100 (Sept. 2016)
California state:	39,000 (Sep. 2017); 39,300 (Sept. 2016)

As of September 2017, the year-to-date sales volume for the entire state was on pace for 347,300. This was a few to several thousand total housing units higher than the same year-to-date numbers posted in September 2016 (345,200) and in September 2015 (341,600).

Listed below are the home sales number trends for Southern California between September 2016 and 2017 by county:

<u>County</u>	<u>Sold Homes (9/17)</u>	<u>Sold Homes (9/16)</u>	<u>% Change</u>
Los Angeles	6,921	7,179	-3.6%
Orange	3,338	3,191	4.6%
Riverside	3,440	3,571	-3.7%
San Bernardino	2,843	2,717	4.6%
San Diego	3,553	3,786	-6.2%
Ventura	861	881	-2.3%
So. Calif. Total	20,956	21,325	-1.7%

The numbers chart below is the median price for the same September 2016 and 2017 time periods as it relates to the median sales price trends in the Southern California region by county:

<u>County</u>	<u>Median Price (9/17)</u>	<u>Median Price (9/16)</u>	<u>% Change</u>
Los Angeles	\$575,000	\$525,000	9.5%
Orange	\$710,000	\$640,000	10.9%
Riverside	\$360,000	\$335,000	7.5%
San Bernardino	\$325,000	\$299,000	8.7%
San Diego	\$535,000	\$495,000	8.1%
Ventura	\$549,500	\$506,000	8.6%
So. Calif. Total	\$505,000	\$460,000	9.8%

But the numbers since 2017 tell a slightly different story. In Southern California, the total sales for 2018 dropped to 230,400, and 211,500 for Northern California. And in 2019, they dropped again to 229,200 for Southern California and 208,300 for Northern California. As of October 2020, home sales in the state over all are down 4% from 2019.

* Source: *CoreLogic*



Increasing Home Prices & Decreasing Demand

The skyrocketing home prices in many parts of the state was one of the main factors for falling homebuyer demand and the reduced number of monthly closings. In 1996, the median valued home in California was just \$150,000. Ten years later in 2006 near the peak of the housing market

boom, the median home value in the state surpassed \$500,000. As such, the median value increased by a whopping 233% in just 10 years.

California residents and real estate licensees have seen extreme price swings from lows to highs over the past two decades or so. Between the home price peak in late 2006 across the state, home median values fell by more than 40% by December 2011 (\$295,300 median home value). That was an eight-year low at the time.

Most of the price and value losses for California homes declined the most between mid-2006 and mid-2009. The regions of the state that experienced some of the worst price drops during this three-year time span were also three of the previous best “bubble” regions that had the highest percentage of price increases. Those regions included Stockton (65% decline), Modesto (65% decline - this area was referred to as possibly the “foreclosure capital of the nation” by some financial analysts), and Merced (69% decline). Earlier in March 2009, the Dow Jones index hovered near 6,500 points as compared with record highs near 23,000 in 2017, and toying with 30,000 in 2020.

Several metropolitan regions in the state did not begin to fully recover and post more positive and encouraging home price increases until 2012. In the 3rd quarter of 2011, more than 40% of all homes sold in the state were either in some stage of foreclosure (i.e., a Notice of Default or Notice of Trustee’s Sale filing status), or already owned by their banks after they took the properties all the way through to the final Trustee’s Sale (source: *CoreLogic*). Also during the 3rd quarter of 2011, an estimated 30% of all California homeowners who had a mortgage in place on their owner-occupied home were “underwater” or “upside down” in that their mortgage balance debt exceeded the current market value of their home. At the time, this was the sixth highest foreclosure rate for a state in the nation after Nevada, Arizona, Florida, Michigan, and Georgia. Yet, California’s largest population base near 40 million residents today meant that California also ranked number one in total foreclosed properties in the entire nation.

Real Estates Salespersons

Income Trends

The reported annual income for Americans can be quite distorted. This is true partly because annual income numbers are generally listed as “household income” more so than individual income. Some households may have two, three, four or more working age adults living in the same residence which may drive up the listed household income whether these adults are married or in a romantic relationship or not, or if they are just roommates struggling to pay their own bills.

To put the wage inequality for Americans into better perspective as compared with the rest of the world, it has been reported by various economic publications that upwards of 50% of the world’s population lives on less than \$2 per day. Additionally, approximately 80% of the world’s population supposedly gets by on earning less than \$10 per day on average. If true, this equates to approximately 80% of the global population existing on an annual income per working age adult of less than \$3,650 per year in income (365 days x \$10 per day income). Just the sale of one lower priced condominium or townhouse in California should net a real estate agent much more than the entire annual income for most of the world’s population.

Let’s review how income is earned across the nation by both the annual income earned and the percentage bracket that this income would place the worker in the annual **Average Wage Index** for the United States. This data was compiled by the U.S. Census Bureau and the Social Security Administration (SSA), among other sources.

Top 1%: As of 2020, the top 1% of all U.S. wage earners collected at least \$361,020 in income from various sources such as their job (employed or self-employed), rental income, and investment income from stocks, bonds, and pension funds. This is up by 44% over the \$250,000 it took to break into the 1% in 2015.

The Middle - 50%: To qualify to be in the top half (50%) of all U.S. wage earners, a person would need to earn more than \$68,400 per year in 2020. This is up from \$63,030.00 in 2019.

The **2015 Poverty Guidelines** that were established by the U.S. Department of Health & Human Services reported that a family of four in one household would have been classified as living under the national poverty levels due to insufficient income if their annual household income was less than \$24,250 per year. Amazingly, an additional \$5,700 + per year in annual income would make this household qualify to earn as much as 50% of all U.S. workers despite the income being so close to the national poverty level numbers.

Here is the 2015 list for the national poverty guidelines created by the U.S. Department of Health & Human Services as based upon the number of residents in the same household and the income threshold level that places a family at the poverty guidelines levels. This is followed by the poverty guidelines for 2020.

<u>Persons in Family / Household</u>	<u>2015 Poverty Guideline</u>
1	\$11,770
2	\$15,930
3	\$20,090
4	\$24,250
5	\$28,410
6	\$32,570
7	\$36,730
8	\$40,890

* Source: <https://aspe.hhs.gov/2015-poverty-guidelines>

Persons in Family / Household**2020 Poverty Guideline**

1	\$12,760
2	\$17,240
3	\$21,720
4	\$26,200
5	\$30,680
6	\$35,160
7	\$39,640
8	\$44,120

* Source: <https://aspe.hhs.gov/2020-poverty-guidelines>

Top Income by % and Amount

To qualify as earning household income in the top 5% in recent years for all Americans, a household would have to earn a combined \$130,000. The top 10% of all household wage earners was \$90,000, and the top 20% was above \$60,000. The bottom 20% and 10%, respectively, were \$5,000 to \$9,999 and somewhere between \$0.01 and \$4,999 per year in income.

5%: \$130,000
10%: \$90,000
20%: \$60,000
30%: \$50,000
40%: \$40,000
50%: \$30,000
60%: \$20,000 to \$24,999
70%: \$15,000
80%: \$5,000 to \$9,999
90%: \$0.01 to \$4,999

Income Distribution

The income distribution by annual household and the percentage of Americans who receive this income is broken down in the following data from the U.S. Census Bureau:

<u>Income Range</u>	<u>Percent Distribution</u>
Under \$15,000	11.6%
\$15,000 to \$24,999	10.5%
\$25,000 to \$34,999	10.0%
\$35,000 to \$49,999	12.7%
\$50,000 to \$74,999	16.7%
\$75,000 to \$99,999	12.1%
\$100,000 to \$149,999	14.1%
\$150,000 to \$199,999	6.2%
\$200,000 or more	6.1%

Knowledge is Power

As income numbers and education statistics tend to support, higher levels of education and ongoing continuing education usually leads to higher income brackets for Americans, especially here in California. In the US Census's last analysis comparing income and education,, the numbers bear this out:

- Less than high school - \$488 per week (\$25,376/year)
- High school graduate - \$668 per week (\$35,776/year)
- Some college/associate degree - \$761 per week (\$39,572/year)
- Bachelor's degree or higher - \$1,193+ per week (\$62,036+/year)

Please remember this college graduate income amount (\$62,000+ per year) when we later compare it with average income for active California real estate agents and brokers.

Also, keep in mind that the latest unpaid numbers for outstanding student loan debt nationally is above 1.6 trillion dollars. Right now, student loan debt for colleges and universities is the #2 overall debt category in the U.S. behind only mortgage loans. Unpaid automobile loans and credit card balances are well over \$1 trillion dollars each as well.

Although college graduates may earn \$10,000 or \$20,000 per year more than a non-college graduate, they also might have a \$50,000 to \$200,000 unpaid student loan debt that follows them around like a proverbial anchor and is magnified in size due to interest. The interest charged for the loans may increase the total amount paid by 200% or more over the life of the debt than the original principal amount. On a comparative basis, a college graduate who finds a job that pays above today's median salaries might actually wind up with less than someone who did not attend college due to the staggering costs associated with unpaid student loan debt.

Today, it is quite common to see annual college tuition rates for some of the best-known universities that exceed \$50,000, \$60,000, or even \$70,000 per year without even factoring in their housing and food costs. When compared with just a few hundred dollars for educational courses related to the real estate profession, real estate seems like a relative bargain with seemingly infinite income possibilities over the span of several decades.

Household Net Worth

For most Americans, the bulk of their net worth originates primarily from the equity in their primary home. A high percentage of the super wealthy here in the U.S. created a significant portion of their family's overall net worth through investments that were directly or indirectly tied to real estate.

In 2020, there were an estimated 97,000 households in America with wages earned that were above \$50 million dollars. To qualify to be in this income bracket, it would place you in the top 0.000125626% range. An estimated total number of 15,298,070 households (11.89%) in the U.S. had wages that exceeded \$1 million dollars annually.



The income listed above for the wage earners in the upper echelon or rank of the highest income does **not** include investment income. Once income levels are reached like the ones above \$1 million dollars per year, the odds are quite high that these households are buying up real estate, stocks, and bonds. As the old saying goes, “it is better to let your money work hard for you than to work hard for your money.” These types of wealthy investors can keep a real estate agent busy for many years to come as the agents assist their clients with buying, selling, and managing properties.

Median Value of Household Assets by Age (without home equity)

<u>Age of Householder</u>	<u>Median Net Worth</u>
Under 35	\$13,900
35 to 44	\$91,300
45 to 54	\$168,600
55 to 64	\$212,500
65 to 74	\$266,400
75+	\$254,800

According to data from the Federal Reserve, the median net worth for those who own a home goes up by 2.8 times over the median net worth for those who do not.

Net Worth with and without Home Equity (2014 number comparison)

<u>Age of Householder</u>	<u>Median Net Worth</u>	<u>Median NW w/o Equity</u>
Under 35	\$6,900	\$4,138
35 to 44	\$45,740	\$18,197
45 to 54	\$100,404	\$38,626
55 to 64	\$164,498	\$66,547
65 to 69	\$193,833	\$66,168
70 to 74	\$225,390	\$68,716
Over 65	\$202,950	\$57,800
Over 75	\$197,758	\$46,936

Using 2014 dollars, the Federal Reserve found that the median net worth of all American households was reportedly \$80,039 if it includes the equity (the difference between the home's current market value and the existing mortgage debt) in the home, condominium, townhome, or co-op unit. (It can make a big financial difference if this same \$80,000+ number

helps pay the bills for one member of a household or if there are four or more family members or roommates sharing the same housing unit.

However, the Fed found that the overall household net worth drops to just **\$25,116** when excluding the equity numbers for one's residential property. As such, the equity in a primary residence represents 68.62% of total net worth for the average household in America. For so many people, the purchase of their primary home will be the most important investment opportunity in their entire life. A knowledgeable and informed real estate agent can be their greatest financial ally in the creation of a large portion of a family's net worth. So, the role of a qualified real estate agent is something that can change lives for the better.

Median Income by Age

Many older Americans earn a higher income than younger ones until retirement age due to training, education, and job experience for professions such as real estate agents and brokers, property managers, doctors, lawyers, and computer specialists. But that isn't always the case. Listed below was the median income earned by household age group in 2017, the most recent data provided by the U.S. Census Bureau and the Social Security Administration:

<u>Age of Householder</u>	<u>Median Income</u>
Under 65 Years	\$69,628
15 to 24	\$40,093
25 to 34	\$62,294
35 to 44	\$78,368
45 to 54	\$80,671
55 to 64	\$68,567
Over 65 Years	\$41,125

Income for Real Estate Agents

Two of the main factors behind how much a real estate agent can make in annual income is related to two issues: 1. the place where they live and work; and 2. how hard and effective they are willing to work.

Most agents will usually earn the bulk of their income from the sale or leasing of residential or commercial properties. Since California is one of the most expensive places to live and work in the U.S. and across the world, agents have better chances working in this state to earn income levels that would place them in the top income brackets. Some agents may specialize in selling high-end homes priced above \$1 million dollars in some scenic coastal communities. Others may specialize in the sale and leasing of high-rise office buildings, retail shopping malls, and industrial storage facilities near transportation centers. If so, these agents might sell one large deal per quarter or year that still nets them a \$100,000 to \$500,000 real estate commission because some of these transactions sell for \$5 or \$10 million dollars each.

National Income Numbers for Real Estate Agents

As per the U.S. Department of Labor Bureau of Labor Statistics (BLS - May 2019), listed below is how the BLS classifies real estate professionals and describes their income on an hourly and annual wage basis across the nation:

Occupational Employment and Wages, May 2019

41-9022 Real Estate Sales Agents

“Rent, buy, or sell property for clients. Perform duties, such as study property listings, interview prospective clients, accompany clients to property site, discuss conditions of sale, and draw up real estate contracts. Includes agents who represent buyer.”

National Real Estate Agents' Mean Annual Wage: \$67,640
National Agents' Mean Hourly Wage: \$32.52 per hour

Percentile	10%	25%	50%*	75%	90%
Hourly Wage	\$14.92	\$20.02	\$28.25	\$40.59	\$62.10
Annual Wage	\$31,030	\$41,630	\$58,760	\$84,430	\$129,160

California Real Estate Agent Income

The income earned as an agent in California as well as the rest of the nation can vary widely depending upon whether the agent is working part-time or full-time as a real estate professional. Some agents may earn zero if they only work a few hours per year while others can collect \$1 million dollars or more in real estate commission income if they consistently close deals monthly, or if they close a few very large real estate transactions that might make them well over \$500,000 or \$1 million dollars in commissions. Those high commissions are typically for properties such as hotels, office buildings, apartment buildings, or large land parcel sales between landowners and multi-billion-dollar real estate developers.

Per the BLS, real estate agents in the state of California earn a **median hourly wage of \$36.35**. The hourly wage range can go from a low of \$12.91 per hour up to \$47.58 per hour within this median hourly wage range. On an annual basis, the median income collected by real estate agents in the state is **\$75,600** per year. The salaries (employed or self-employed) can vary from a low of \$26,850 up to \$98,970 per year.

Often, it will be directly up to the individual real estate agents how much income they will earn in their first year of business and for every year thereafter. At first, employing brokers might agree to split the commissions with brand-new agents on a 50/50 basis (50% to the

brokerage firm; 50% to the salesperson). As the agent closes more and more deals, the employing broker may slowly or quickly increase their commission splits to 65/35 (65% to the salesperson; 35% to the broker), 70/30 (70% to the salesperson; 30% to the broker), or up to 80/20 (80% to the salesperson; 20% to the broker) or even higher commission splits for the very best real estate agents in a brokerage firm. With more closed real estate deals at much higher commission splits, an agent may start to earn \$10,000 or more every month.

Agents who work more than 60 hours per week in California earn a median income of \$87,000. An estimated 21% of real estate agents in the state earn over \$100,000 per year. Some of the absolute top real estate agents in the state can consistently earn over \$100,000 *per month* (\$1.2 million or more each year) if they work hard, develop an incredibly effective marketing plan, treat their clients and prospects equally and fairly, and focus on their daily tasks at hand by striving to reach their weekly, monthly, and annual income goals.

An agent working on a real estate deal in California will likely have several easy and challenging deals. Sometimes, the clients are a pleasure to work with, the property is in nearly perfect condition, and the deal closes well under the target scheduled closing date. On an hourly basis for these solid deals, the agent might collect a commission check that was based on about \$1,000 per hour in income (for example: a \$10,000 commission check that was earned after spending a grand total of 10 hours on the deal with the client, property, the other agent, and with third party specialists). Other times, the agent works for several months to collect an income check that ended up being closer to \$50 per hour for all the hard work that was put into the deal.

Few professions in the state, nation, or world offer people the chance to reach or exceed their desired income goals than the real estate profession, especially right here in the Golden State of California.

Why and How the Mortgage Broker Profession Changed

Many times, a real estate licensee would act as the buyer's broker and collect their share of the 3% commission as based on the purchase price and collect a mortgage broker fee for assisting with the purchase loan for the buyer (1% to 2% of the funded loan amount). On a \$500,000 purchase transaction with a 90% LTV (loan-to-value) first mortgage loan that amounted to \$450,000, the licensee might earn upwards of a \$24,000 commission on just one deal ($\$500,000 \times 3\% = \$15,000$; $\$450,000 \times 2\% = \$9,000$). If so, the agent would earn almost as much money on just one deal as the average American brought home for a year's worth of work.

California had the highest number of foreclosed properties over the past 12 to 15 years as compared with the rest of the nation. Not only did our state have the highest number of foreclosed properties, it had the highest dollar amounts of delinquent mortgage loan payments due to the fact that California has some of the most expensive real estate in the world.

Shortly after the passage of the Dodd-Frank Act and the creation of the Consumer Financial Protection Bureau, government agencies began to demand that people who wish to work on owner-occupied residential mortgage transactions (one-to-four units) also had to qualify for and pass the MLO (Mortgage Loan Origination) license endorsement exam. The MLO endorsement only applies to owner-occupied residential deals rather than private-money non-owner investor loans or commercial loan transactions. The latter included properties such as apartment buildings with five or more units, office buildings, industrial warehouse properties, raw land, mixed-use property, and various other types of non-owner-occupied properties.

The stated goals and intent for the MLO license requirement was to protect homeowners from losing their primary residence due to unscrupulous or dishonest mortgage professionals. Those mortgage professions who lacked integrity, among other qualities, were placing

naive, innocent, and uninformed mortgage borrowers into risky types of negative amortization adjustable-rate mortgage (ARM) loans that could double in monthly payment amount just a year or two after the loan began. Some of the more notorious adjustable-rate loans had teaser rates starting as low as 1% that were amortized over 40-years instead of just 30-years for lower perceived payments.

The true note rates on those loans started closer to 7% after adding the index [11th District Cost of Funds (COFI) or the Monthly Treasury Average (MTA)] to the margin. Often, the true index rate that the ARM loan was tied to was 4.5% and the margin was 2.5% ($4.5 + 2.5 = 7\%$ true note rate). If a borrower paid the lowest monthly payment option out of the three or four monthly payment options provided, he or she might be deferring a few hundred dollars or more in unpaid interest that increased the size of the borrower's mortgage debt. For mortgage loans that were over \$1 million dollars, the deferred interest payments might grow by tens of thousands of dollars each year up until the lender demanded that the full principal and interest amount needed to be paid. If so, the monthly mortgage payments could go from \$3,000 per month to \$6,000 per month in less than a year or two from the start date.

The three or four monthly payment options that a borrower might have available to them from past adjustable rate and "EZ Doc" lenders such as Countrywide Mortgage, World Savings, Downey Savings, and Washington Mutual (the largest bank collapse in U.S. history) might have included these payment options below:

Payment Option #1: Minimum Payment (1% start rate, 40-year amortization): \$874 per month

Payment Option #2: Interest-Only [7% true note rate - 4.5% index (a floating or adjustable rate that is tied to some sort of a definable interest rate index such as a COFI or MTA index) + a 2.5% fixed margin rate that never changes): \$1,420 per month (no mortgage principal amount is paid down)]

Payment Options #3: Principal and interest payments amortized over 40 years (the true note rate of 7% plus a consistent fully amortized principal payment amount that may eventually reduce the mortgage amount down to zero over the period of 40 years): \$1,637 per month

Payment Option #4: Principal and interest payments amortized over 30 years (note rate of 7% plus a partial payment towards principal each month that may one day pay the mortgage balance down to zero in 30 years): \$1,752 per month

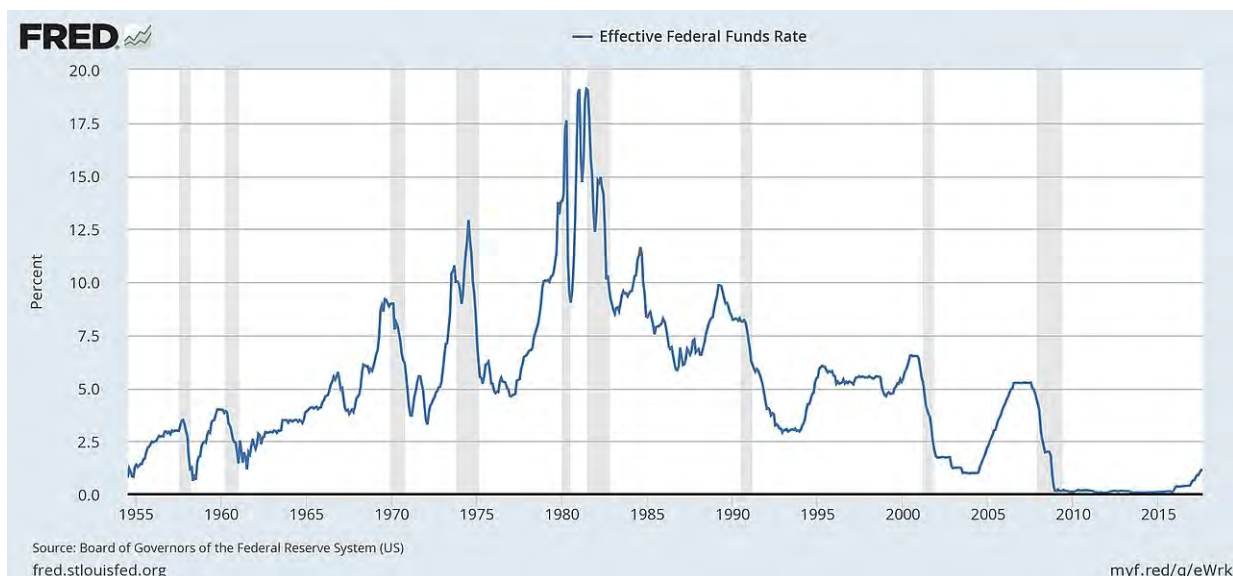
With mortgage loans, longer amortization terms of 40 years usually meant lower monthly payments for borrowers than short 30 or 15-year mortgages. The downside risk for borrowers is that they will generally pay much more in interest payments over the life of a loan with a much longer amortization or payment schedule than they would a shorter-term loan.

Historically, the typical California resident holds their same mortgage loan for an average term of just seven years. This is due to such factors as they may only live in the home for five or seven years prior to selling it and paying off the original purchase loan in full. Or the same homeowner will later refinance their purchase loan in order to qualify for a lower interest rate and/or pull some additional funds out of a new loan so that they may make some improvements to their property or pay off some of their consumer debt. As such, adjustable-mortgage rate loans did not seem as risky several years ago to so many California residents.

Interest rates have wildly fluctuated like a yo-yo over the past few decades from extreme highs to all-time record lows. For example, the U.S. Prime Rate reached a staggeringly high 21.5% rate beginning in December 1980 while various other types of interest rates have reached lows somewhere within the 0% to 1% rate range. These days, some financial analysts are likelier to be concerned about interest rates going negative below the 0% rate instead of increasing to double digits once again.

At the start of the 21st century in the year 2000, the Federal Reserve's **Fed Funds Rate** (a key overnight lending rate that helps establish a starting point for many other types of short-term mortgage and consumer loan rates) reached 6.5% near the summer months. While 6.5% wasn't *that* high as compared with past index rate changes over the previous few decades, it was still much higher than index rates had been over most of the past few years. The **Discount Rate** is the rate that the Federal Reserve charges to lend to banks, and it directly impacts cash flow to the mortgage markets. It increased right along with the Fed Funds Rate when the Fed was concerned about higher inflation rates.

Up until September 11th in 2001 when the world witnessed the destruction of the World Trade Center in New York City and damage to the Pentagon in Washington D.C., rates did not change very much. But a few days after the 9/11 attacks, the financial markets began to fall as the Dow Jones index dropped 684 points (a 7.1% overall price dip). Even though the financial markets were closed for a few days after 9/11, partly because much of the destruction was so close to Wall Street, when they reopened, the Dow Jones index dropped almost 1,370 points (a total overall loss of 14%) and the Standard & Poor's (S&P) index lost 11.6% of total overall value.



Interest rates had reached their peak highs (for that time period) shortly before the 9/11 destruction in the fall of 2001. After the stock prices began to fall at a worrisome rate, the Federal Reserve started cutting their key short-term interest rates. This was the Fed's attempt to stimulate the financial and housing markets once again so that the overall financial system would not end up declining as badly as they had during the depths of the Great Depression (1929 to 1939).

To best stimulate the financial markets and to inspire faith in the overall U.S. economy, the Fed thought it would make consumer and mortgage loans as affordable as possible. This included allowing more mortgage lenders to offer "EZ Doc" loans with no income and/or asset verification so that property values would not fall too quickly. Since most Americans have the bulk of their net worth tied up in the equity in their primary home, the Fed's strategy of taking key mortgage lending rates to near record lows (from 6.5% down to 1%) within less than two years between 2001 and 2003 seemed to make sense. Perhaps at no other time in the banking history of the United States did adjustable-rate mortgages seem like the best idea possible for owners, investors, real estate agents, and mortgage brokers.

The problem however with adjustable-rate mortgages is that they do not always continue to move downward. Just like with a yo-yo, once the toy or mortgage markets have reached their absolute lows, they will likely snap back up again and figuratively or literally hit the person in the nose. The interest rate shock experienced by mortgage borrowers later caused many of them to lose their homes to foreclosure.

About six months before the Fed began rapidly increasing their key overnight lending rate called the Fed Funds Rate, past Fed Chairman Alan Greenspan famously said in a public statement something to the effect that "adjustable-rate mortgage loans might save homeowners thousands of dollars per year" as compared with a traditional fixed rate mortgage. Because Mr. Greenspan was the man in charge of the Fed, it seemed wise for mortgage borrowers to select adjustable-rate mortgages

being offered with no income verification options from some of the most successful and profitable lenders in the country, named Washington Mutual, Countrywide, IndyMac, and World Savings.

Unfortunately though, the Fed began a series of massive rate hikes about six months after Fed Chairman Greenspan had strongly encouraged mortgage borrowers to seek out adjustable-rate loans. **Between 2004 and 2006, the Federal Reserve raised its Fed Funds Rate a total of 17 times and Rate increased from 1% up to 5.25%.** The Fed was so concerned about how quickly inflation and asset prices were moving between 2002 and 2004 that they thought that the rate hikes might slow down the rapidly increasing inflation rates.

Instead of inflation being the main thing to worry about in the economy after 2006 however, it was asset deflation that became more worrisome to the Fed, investors, real estate agents, and the rest of the American public. Borrowers with adjustable-rate mortgages saw their mortgage note rates go from 5% to 9.25% or higher as their monthly mortgage payments began doubling or tripling. Home values began to fall at a rapid rate due to the incredibly high number of foreclosed properties within a one-mile radius of many owners' homes. Those foreclosed properties were becoming the main sales comparables ("comps") for other homeowners in the neighborhood who were still making their mortgage payments on time.

The Credit Crisis Worsens

Mortgage brokers and some real estate agents began to see signs of an impending slowdown in the mortgage markets in early to mid-2006 as some lenders stopped offering certain types of their once favorite mortgage loan programs such as "No Income Verification" (NIV) or "No Income and No Asset" (NINA) verification programs. Some negative-amortization mortgage loan programs with 1% or 1.25% starting payment rates were beginning to disappear as well. Between the summer of 2007

when the Credit Crisis officially began and the fall of 2008, more and more mortgage lenders stopped offering any type of subprime-credit, EZ Doc, or negative amortization adjustable-rate mortgage programs because these lenders already had too many non-performing mortgage loans on their books at the time.

Some financial analysts claimed that upwards of 80% of all purchase-money Jumbo loans (above \$417,000 at the time) issued in Southern California in the mid-2000 years were some form of an adjustable-rate mortgage option or a fixed/adjustable mortgage hybrid like a 3/1 or 5/1 program. That means that the loan was at a fixed rate for 3 or 5 years before converting to an adjustable rate for the remainder of the loan term. And some of the loans were issued under an “EZ Doc” loan program with no verifiable source of income necessary to qualify.

One of the main reasons why some pricey homes near coastal communities began to go into foreclosure at high rates was that these “EZ Doc” and adjustable-rate mortgage options that were used to purchase their properties were no longer available for homeowners to refinance themselves out of their mortgage debt. Additionally, there were fewer qualified buyers for properties priced above the low \$400,000 price range that could bring in a new purchase loan to cash out the delinquent homeowner at a future sale.

In September 2008, the worsening Credit Crisis became much more apparent and obvious to the general public after some of the most famous financial firms like Lehman Brothers, Bear Stearns, AIG, Merrill Lynch (once the world’s largest stock brokerage firm), and Washington Mutual either went out of business or were bailed out by other larger financial firms with or without the assistance of the federal government. On September 29th, 2008, the Dow Jones index dropped a record 777 points as more investors became fearful of the solvency of the entire U.S. financial system. Just six months later in a Congressional subcommittee hearing, past Federal Reserve Chairman Ben Bernanke (who replaced Alan Greenspan) told the panel that the world’s financial system almost

imploded or collapsed on September 29th, 2008.

With so many financial firms running out of cash and millions of homeowners losing their properties in foreclosure, investors, government agencies, and real estate professionals began searching for the most cost-effective solutions that could be beneficial for borrowers, investors, banks, and insuring government agencies. The changes to regulations would alter the mortgage lending market and the real estate profession for many years to come. Some agents would find new ways to create business opportunities while other agents were forced to seek new careers as their deals began to dry up, partly because many of their best clients wound up in bankruptcy court.

The origin of the word “crisis” is claimed to have originated from two Chinese characters which represent these two seemingly contradictory or opposing meanings: “danger” and “opportunity.” Depending upon one’s perspective, times of economic crisis can present significant financial risks, or the best opportunities. For example, foreclosures are financially harmful to borrowers and their lenders while at the same time offer incredible new opportunities to real estate agents who focus on specializing in discounted property sales and buyers who are looking for a bargain. If the broker is successful enough, the banks start calling that broker to list some of its hundreds of thousands of foreclosed properties that are located within the same area where the broker has his or her office.

Foreclosures and Short Sales

Between 2006 and 2008, millions of homes went into foreclosure across the nation due to a major confluence in the financial markets. As discussed above, we saw rising mortgage rates; the implosion and subsequent bankruptcy of several of the most prominent adjustable-rate and “EZ Doc” lenders; the disappearance of “EZ Doc” mortgage underwriting programs that allowed borrowers with lower FICO credit

scores (or “subprime credit”) and no tax returns to qualify for a loan; and falling neighboring property values that were directly related to hundreds of properties being foreclosed on by their lender.



In other states, like Texas, lenders might have the legal right to sue for financial losses if the property owner loses a home to foreclosure and the owner’s debt to the lender exceeds the property’s current market value. That is called a “deficiency judgment.” But California does not typically allow “deficiency judgments” from mortgage lenders in a foreclosure situation like that. Borrowers in “upside down” properties (where the mortgage debt exceeds the property’s current market value) have little incentive to not just walk away from their property since they know that their mortgage lender cannot sue them for any financial losses.

In California, borrowers who could no longer afford their mortgage payments that had doubled or tripled in size, would sometimes just drop the keys off at their local bank after living there several months or years without paying any sort of mortgage or rental payment fee. Some lenders were forced to create “Cash for Keys” type programs in that they would literally write a check for thousands of dollars to the homeowner to give them back the keys to their home and sign over the deed to the foreclosing lender.

Some of the most fortunate homeowners had not made a mortgage payment in three to five years prior to the lender actually paying them to “walk away” from the home. Because foreclosure rates were approaching records highs, especially in states like California, many lenders refused to file foreclosure notices because they already had too many in their pipeline. These same banks had concerns that their stock prices might fall too quickly if their shareholders realized that 20% to 40% of their entire mortgage portfolio might be delinquent or in some stage of foreclosure.

The concept of “**Short Sales**” became more fashionable for homeowners and real estate agents. With this type of real estate sales transaction, homeowners would list a home for sale (that may or may not be currently delinquent or in foreclosure) with a local real estate agent. The lender, in turn, would try to get the highest offering price from a qualified buyer. Once the purchase deal was in hand, the real estate agent would work closely with a lender’s “loss mitigation” office, or the like, up until the lender would hopefully approve the purchase offer price that might be well below the lender’s mortgage debt balance.

For example, a buyer’s broker would bring in an offering price of \$275,000 along with a formal mortgage qualification letter for a property that had \$350,000 in existing mortgage debt with the bank. After factoring in commissions and closing costs to be paid, the lender might net approximately \$262,000 in this fictional deal. If the lender would accept this net offering price of \$262,000, the lender would lose, on paper, a total of \$88,000 (\$350,000 - \$262,000). The Short Sale opportunities became so prevalent throughout California after 2006 that more and more real estate agents and brokers began specializing in Short Sale transactions.

Chapter One Summary

- There were **6.85 million housing units** sold by the month of October 2020; the median price for the sold homes nationally reached \$313,000.
- The **Santa Maria/Santa Barbara** metropolitan region was the number one most expensive housing region in the nation with a median list price of \$1,377,000 as of October 2017. The **county of San Francisco**¹ was ranked the most expensive county with a median list price of \$1,295,000.
- In September 2017, the total number of new and resale homes that closed escrow in California reached approximately 39,000. This 39,000 figure is almost half of June 2005's monthly closing.
- During the depths of the Credit Crisis, price and value of California homes declined the most between mid-2006 and mid-2009. The city of Merced fell the most with an average 69% price decline, and Stockton and Modesto followed closely behind with 65% losses each.
- To qualify to be in the top half (50%) of all U.S. wage earners, a person would need to earn more than \$68,400 per year in 2020. The latest reported national guidelines for the poverty line is \$12,760 for a household of one person. The median income earned by California real estate agents in 2020 is **\$75,600** per year.
- The bulk of a person's overall net worth in the U.S. comes from the equity in their main residence. The equity in a household's primary residence represents **68.62% of total net worth** for the average household.

¹ The County of San Francisco consists entirely of the City of San Francisco.

- The Federal Reserve raised its Fed Funds Rate **17 times**, and the Fed Funds Rate increased from 1% up to 5.25% between 2004 and 2006. Beginning in 2007, millions of homes were foreclosed on in just California alone partly due to falling property values and tougher mortgage lending standards. Some regions in the state fell 50% in value within a few years.
- **Short Sale** opportunities became some of the best and most profitable business strategies for agents in the state once they learned how to effectively work with the banks.

Chapter One Quiz

1. According to the National Association of Realtors, how many homes sold across the nation in October 2020?
 - A. 3.2 million
 - B. 4.16 million
 - C. 6.85 million
 - D. 5.48 million
 2. Which metropolitan region in California had the highest list prices as of October 2017?
 - A. San Francisco/Oakland
 - B. Los Angeles
 - C. San Jose/Sunnyvale
 - D. Santa Maria/Santa Barbara
 3. Which California county had the highest median list prices as of 2017?
 - A. Los Angeles
 - B. San Francisco
 - C. Orange
 - D. Santa Clara
-

4. How many active real estate brokers were in California as of 2020?
- A. 93,795
 - B. 124,700
 - C. 148,300
 - D. 195,500
5. How many active real estate salespersons (agents) were in California as of 2020?
- A. 112,800
 - B. 206,308
 - C. 249,230
 - D. 317,920
6. Over the past several decades, what was the average ratio of active salespersons to brokers in California?
- A. 5 to 1
 - B. 4 to 1
 - C. 2.5 to 1
 - D. 1.5 to 1
7. Per federal poverty guidelines established by the U.S. Department of Health & Human Services, which income level was considered the national poverty line for a family of four living in one household in 2020?
- A. \$11,720
 - B. \$18,360
 - C. \$26,200
 - D. \$29,590
8. Which household annual income amount would qualify as the top 5% for all families throughout the country in recent years?
- A. \$182,000
 - B. \$130,000
 - C. \$107,000
 - D. \$91,000

9. Nationwide, what percent does the equity in a primary residence represent for a household's overall net worth?

- A. 68.62%
- B. 57.18%
- C. 51.94%
- D. 42.84%

10. What was the median hourly wage collected by real estate agents in California as of 2019, per the Bureau of Labor Statistics?

- A. \$17.40
- B. \$21.80
- C. \$36.35
- D. \$29.75

11. What was the median annual income earned by California real estate agents as of 2019, per the Bureau of Labor Statistics?

- A. \$23,925
- B. \$31,740
- C. \$42,892
- D. \$75,600

12. How many times did the Federal Reserve raise its Fed Funds Rate during 2004-2006, just a year before the official start of 2007's credit crisis.

- A. 17
- B. 14
- C. 9
- D. 5

Answer Key:

1. C	6. D	11. D
2. D	7. C	12. A
3. B	8. B	
4. A	9. A	
5. B	10. C	

CHAPTER 2

Career Opportunities and Agency Relationships

Overview

This chapter is about the establishment of agency relationships between real estate agents and principals as well as between agents and other agents. Real estate agents owe various duties to both principals and other agents such as loyalty, confidentiality, accounting, and honesty. The business and income opportunities for agents seeking work in fields related to real estate and mortgages will be addressed as well.



Agency Relationships

Most real estate licensees who work in the field will probably work in a small to large brokerage office as a self-employed, independent contractor. The agent may be willing and open to working on many different sides of the real estate profession as a buyer's agent, listing agent, dual agent, leasing agent, land broker, commercial real estate agent, mortgage broker (private money or commercial brokerage without the MLO license or as a fully licensed MLO agent), or in the buying and selling of business opportunities or franchised businesses. Sometimes, agents need to be more open-minded with respect to working on as many different sides of the business as possible to generate consistent income. The exposure to the various sides related to agency may also allow the agent to find one or two core business strategies that suit his or her skills and interests prior to later fine tuning and improving those strategies over time.

What is an agent? An agent is a person who has been appointed by a **principal** (also referred to as a client or customer) to represent him or her in dealing with **third parties**. The most common types of principals that agents will work with in the real estate profession are buyers, sellers, landlords, and tenants. The **rules of agency** apply to relationships between agents and principals and agents (brokers and salespersons) and other agents.

An agent can have the following types of agency relationships:

- Buyer's Agency
- Seller's Agency
- Dual Agency

A buyer's agency relationship is primarily focused on representing his or her client's needs as a buyer, while a seller's agency relationship concerns listing arrangements between sellers/owners and their listing agents. Both the buyer's and seller's agency relationships are forms of single

agency since only one principal is represented at a time. For a **dual agency relationship** when the agent represents two parties (buyer and seller or lessor and lessee), that relationship must be fully disclosed to both parties in writing.

An agency relationship and/or a contract may be terminated if the broker's license has expired, the broker or principal passes away, or the agent and principal mutually agree to it.

The term "real estate agent" may be applied to someone holding an active salesperson or broker's license. However, only the employing broker in the office is the main agent involved in any transaction that originates from his or her office. Even though it was the salesperson who brought in her sister for the new listing transaction, it is still the employing broker who is the true agent involved in the listing agreement.

All real estate commissions from the future sale of the salesperson's sister's property will be paid directly to the broker first. It will then be up to the broker to pay the mutually agreed upon broker/salesperson commission split to the selling salesperson.

A salesperson is usually an **independent contractor** when working under a broker's license. A determining factor for whether someone is considered an independent contractor is whether he or she is paid primarily with commission income. For tax purposes, the agent will typically file his or her tax returns as a self-employed person.

Under the eyes of the law, the true "selling agent" is the broker even if he or she never set foot on the property being sold or had one conversation or email exchange with the selling principal. The broker can be an individual or a corporate entity in any transactions that close escrow under that individual's or entity's broker's license. As such, the main "selling agent" might legally be "XYZ Realty" instead of the listing salesperson who is named on the real estate sign on the front lawn. Note that a corporation may be licensed as a real estate broker through one or

more of its officers who are brokers or have qualified for a broker license by examination.

In listing transactions, the agent handling the listing agreement for the selling principal is the **seller's agent**. The other licensee in the transaction who brings in the buyer to purchase the listed property is the **buyer's agent**. In some cases, the listing agent and the buyer's agent may be one and the same, i.e., he or she represents both the buyer *and* seller in the closing. This type of agent is called a **dual agent**. The buyer's agent may collect double the commission fees (6% of the selling price), but he or she also has double the amount of financial, legal, and licensee liabilities. Or, it is the dual agent's employing broker who has double the potential liability since all true risks ultimately end up with the broker.

Finder: A real estate agent who has no formal agency relationship with a buyer or seller while acting as a neutral middleman and providing minimal details while not planning to offer more services is called a **finder**.



Broker and Salesperson Relationships

The main employing brokers in real estate firms need to be extra cautious with respect to who they hire to represent them to the public. Any newly hired real estate agents who intentionally commit fraud just to collect a commission to pay their monthly bills will jeopardize both their own as well as the broker's individual and/or corporate licenses. Sometimes an inexperienced agent will not knowingly commit fraud, but his or her actions might amount to "legal misrepresentation" and can still put the employing broker's license at risk for suspension and tens or hundreds of thousands of dollars of civil court judgments.

To minimize risks for both employing brokers and the salespersons who hang their licenses under those brokers, the brokers should insist that the salespersons and any other brokers under their main license take the following steps:

- Keep up to date with their continuing education courses in a timely fashion.
- Attend weekly or monthly training classes held at the main brokerage office or at their branch offices. These training classes should especially focus on risks associated with any perceived violation of Fair Housing, advertising, and trust-fund handling actions that could be financially devastating for the entire brokerage firm should any court later find them guilty of misrepresentation.
- Share the latest rule or regulatory changes passed or enacted by the state, the DRE, the local real estate board, or the broker's own office. The most important rules to follow for agents are the ones established by their employing broker. If those rules are regularly broken, the broker is likely to ask the agent to find another office for employment.
- Treat their clients, other agents, and third parties involved in every transaction equally and fairly. The real estate profession is based

upon personal interactions and relationships with multiple parties in the transaction instead of just the representation of the sale or leasing of a specific property. Agents who have a reputation around town of mistreating their clients, other agents, and third-party professionals (such as escrow officers, title representatives, appraisers, home inspectors, and others) are not going to be welcomed into too many new transactions, especially if there are multiple bids on the property that his or her client wants to buy.

Agent's Duty to the Principal

If agents do not agree to follow the rules established by their brokers, they will likely be asked to leave the brokerage firm. In individual real estate transactions, it is the principal who the agent owes the most duties to in each deal. Agents owe a **fiduciary duty** to their clients with whom they have a fiduciary relationship. A fiduciary relationship is one that is built upon a position of trust, somewhat like a relationship between an attorney and his or her client. The agent and principal relationship must include utmost care, obedience, accounting, loyalty, and the disclosure of material facts. **COALD** is the acronym used to remember an agent's duties to his or her principal. Let's review those duties.

Care: Agents owe their clients the utmost care when representing them in a real estate transaction. All real estate agents are expected to act with a certain level of care and skill like any other competent and knowledgeable agent would act in the same transaction. If the agent's performance level falls well below what any other agent would do if they were working on the same transaction, then the agent may be faced with legal, license, and financial liabilities.

Obedience: An agent must obey his or her principal's written and spoken instructions as long as those instructions are legal. The agent must carry out those instructions in good faith, and with honesty and integrity. Should the agent not follow their principal's instructions, he or she may

be potentially liable for financial losses and possibly be faced with license suspension.

Accounting: Agents must be able to keep an accurate accounting of any funds collected from or on behalf of their principals. These types of funds are referred to as **trust funds**. Agents are required to keep their client's funds (i.e., rents collected, earnest money deposits paid to buy homes, etc.) separate from the broker's personal or business accounts. If not, both the salesperson and the employing broker may be faced with serious legal and licensee liabilities if they mix up (also called "**commingling**") client funds with broker funds or spend the client's money on their own personal or business expenses (known as "**conversion**").

Loyalty: The client's needs and interests should be placed well above anyone else's in the deal. The old saying about business which claims that "the customer is always right" really does apply here in agency relationships. An agent cannot make any hidden or **secret profits** from the agency relationship that are not fully disclosed to the client. Another important part of the loyalty concept is that agents must act with **confidentiality** by not sharing any truly confidential information disclosed by the principal to the agent, whether it is during the course of the transaction or for many years afterward.

Disclosure of Material Facts: Agents are required to disclose all known material facts to the principal, other agents, and to other clients involved in real estate transactions. A **material fact** is one that is so important that it could cause a buyer to back out of a purchase deal (e.g., the home sits on a cracked foundation, or the roof leaks so badly that it may not make it through the next severe rainstorm).

Agent's Duties to Third Parties



Even if the seller does not fully disclose all property defects that he or she is aware of to buying prospects, the listing broker must still disclose any known material facts to the buyer and the buyer's agent or be at risk of having his or her license suspended or revoked along with serious financial liability should the matter be taken to court. The agent owes his or her utmost loyalty to the principal who granted him or her power to act on the principal's behalf after the principal appointed or selected that agent. In addition, the agent owes certain legal duties to parties who the agent is not representing in the transaction as well.

These **agency duties owed to third parties** are:

Reasonable Care and Skill: An agent is expected to act as professionally with his or her clients and third parties as any other agent would if they were "in his or her shoes" in the same deal. Any agent who harms a third party by the agent's incompetence or carelessness might be liable for that third party's financial losses

and face possible license suspensions. Plus, that agent will earn a bad reputation around town with other agents and principals.

Good Faith and Fair Dealing: Agents must treat third parties with honesty, truthfulness, and fairness. Making intentionally false statements or even slight misrepresentations to third parties that cause them or their clients harm would be considered a breach of this duty. Principals are also bound by this duty to treat third parties with honesty and fairness, or they may also be financially liable to any injured parties who took actions partly based on following the principal and/or agent's less than truthful words.

Disclosure of Material Facts: There is a reason why most disclosures are made in written documents. It is partly so that one or both parties do not later come back and file lawsuits against the other party for not properly disclosing any defects found in the property shortly after the close of escrow or even several years later. Both principals and listing agents must fully disclose any known defects on these written disclosure forms to buyers and to the buyers' agents, even if the seller and listing agent disagree with what must be fully disclosed to third parties.

Commissions

Most real estate agents earn the bulk of their income from the commission collected from the sale or leasing of residential or commercial property. When an agent is hired by a new employing broker, the agent must sign a written employment and agency contract which fully outlines what the expectations are between the broker and the salesperson as well as what will be the first commission split levels between the two parties. This employment contract should also provide details with respect to how an agent may later increase these commission splits based upon either the number of individual closings, the combined dollar amount of the closings, or some other factors.

Brokers who own office space will usually have a significant amount of expenses that they must cover or pay for each month. These expenses can include the rent or mortgage payment for their office space or building, fees for utilities, such as telephone, electric, and internet service bills for their computers. If a broker does not collect enough monthly income from either his or her own brokerage sales or from a percentage of the commission splits from his or her agents' sales under the broker's license each month, then he or she might be forced to later close down the office. So, it is important that the commission splits be fair for the employing broker and fair for the agents under them, or neither one of them may be working too long in the industry.

Broker/Agent Commission Split

Any commissions are fully negotiable between the employing broker and his or her agents. Sometimes, an agent will start out with a 50/50 split (50% to the broker and 50% to the salesperson) for the first few months to a year. After the agent closes escrow on a certain agreed-upon dollar amount of sales, such as over \$1 or \$2 million, then the broker may boost the commission split up to 65/35, 70/30, or 80/20 if the agent closes a high number of transactions over time. It will be the salesperson earning the majority of the fees (65%, 70%, or 80%) in these higher commission-split options.

Disputes Over Commission Payments: Should any commission disputes later arise between a salesperson and the main employing broker, then the options to resolve include:

- Arbitration
- Mediation
- Court (Small Claims up to \$10,000 or Superior Court for greater amounts)
- The California Labor Commissioner's office

The risks associated with ending up in potentially lengthy and costly legal battles over commission disputes should be minimized with a firm-and-detailed commission split agreement in place between the broker and salesperson.

Other commission disputes might arise between two or more agents if they each allege that they were the “procuring cause” (or the main agent) who brought in the “ready, willing, and able” buyer to close escrow. One of the best ways to reduce the odds of a commission dispute over which agent was actually working with the principal who bought the property is to have a signed and up-to-date buyer’s agency agreement in hand. These types of contracts will be addressed later in the course.

How Access to Capital Drives the Markets

During times when access to money is easier with lower rates and more flexible approval process options, home values have historically increased at much faster rates of appreciation than the reported national inflation rates. Conversely, tighter lending markets with higher rates and more difficult mortgage underwriting guidelines usually lead to slower home price gains. In recent years, we have seen record low interest rates and more challenging loan approval process steps that benefit some and hurt other mortgage applicants.

In the majority of home-buying transactions that real estate licensees will work on in their careers, the buyers are dependent upon access to some form of third-party capital to complete the purchase. Often, the funds will come from their local bank, credit union, or mortgage broker in person or from an online source. Buyers and sellers usually need third-party funds either directly or indirectly to get into and out of residential or commercial properties. When the access to funds decreases, then the number of properties sold tends to fall as well. Conversely, an improved access to capital or money sources usually inspires more buyers to purchase properties while boosting property values as well.

Over the past decade or so, real estate agents have seen third-party mortgage lending sources go from offering relatively easy loan qualification guidelines to much more difficult mortgage lending requirements. It really does not matter much if interest rates are still at or near all-time record lows if the borrower cannot qualify for the loan because of a low FICO credit score, minimal cash reserves, and/or a debt-to-income ratio that lenders consider too high to qualify for the mortgage.

How Debt Sinks Capital Access

Debt is an anchor that can sink many real estate deals today. This is especially true because more Americans today have consumer debt than ever before. Too much debt for a mortgage borrower applicant can be the difference between buying or renting a home. It can also determine whether a home buyer uses conventional or private money to buy property, assuming they can qualify at all.

Lenders prefer income levels much higher than debt levels before they will agree to approve a loan request. A **debt-to-income ratio** is structured and analyzed two different ways by most lenders. First, the **front-end debt ratio** is calculated by dividing the proposed new monthly mortgage payment (principal, interest, taxes, and insurance) into the borrower's gross monthly income. A borrower applicant with a \$5,000 gross monthly income and a proposed new \$1,000 per month mortgage payment on a small condominium unit would have a 20% front-end debt ratio ($\$1000/\$5,000 = 20\%$).

The **back-end debt ratio** is calculated by mortgage underwriters taking all the mortgage applicant's monthly debt obligations (e.g., their monthly car, credit card, and student loan debt payments), adding it to the proposed new mortgage payment, and dividing it by the person's gross monthly income. A borrower with \$2,000 per month in total monthly debt obligations would have a 40% back-end debt ratio if they earned \$5,000 per month in income ($\$2,000/\$5,000 = 40\%$).



The problem for many mortgage borrower prospects is that they might have had a past foreclosure, bankruptcy, or tens of thousands of dollars in credit card debt holding them back from qualifying for new conventional loans. As a result, many of these mortgage loan applicants would seek out mortgage brokers or mortgage bankers who had access to many more different lenders that ranged from private money lending sources to investment funds on Wall Street. Instead of just one lender telling a mortgage applicant a quick “yes” or “no,” mortgage brokers could work towards getting the mortgage prospect potentially five or 10 different approvals from interested lenders.

As lending options became more challenging for mortgage borrowers and home buyers, home prices either stagnated or fell in several markets around the state and the rest of the nation. As a result, sellers and real estate agents had to get more creative by finding new money sources. Such sources as private money lenders and crowdfunding platforms for real estate became viable options. Those types of lenders were pooling millions or billions of dollars from individual and institutional investors prior to lending them out to borrowers in desperate need of loans for their residential or commercial real estate properties. Many of these private

loan options allowed back-end debt ratios as high as 50% to 60% for qualification purposes.

Because interest rates had fallen so much after 2008 for conventional mortgage loans, the borrowing costs for private money lenders fell as well. Instead of double-digit mortgage rates like in years past that were offered by private money or “hard money” lenders, the more recent private money rate programs were instead in the 6% to 8% range. An investor who could qualify for a private money-type mortgage loan at 7%, for example, instead of being denied a 5% fixed mortgage rate from their local savings bank, was more likely to accept the higher 7% rate because it was better than nothing at all.

Mortgage Brokers/MLO

Beginning in late 2008, the rules began to change significantly for mortgage professionals who had focused primarily on funding owner-occupied residential purchase or refinance mortgage loans. In the past, some mortgage brokers only worked on residential mortgage loans for one-to-four units while other mortgage professionals preferred to work on commercial mortgage loans for properties such as small (5+ unit) to large multifamily apartment buildings, office buildings, or industrial buildings. Other mortgage professionals might have preferred to work on both residential and commercial mortgage loan source options because their employing mortgage brokerage firm had access to many mortgage lenders.

The mortgage industry really started to change beginning on July 30, 2008 after the **SAFE Act (The Secure and Fair Enforcement for Mortgage Licensing Act of 2008)** was enacted as a response to the record number of delinquent or foreclosed residential mortgage loans across the nation. Out of the passage and subsequent enforcement of the SAFE Act, the concept of a nationwide licensing and registration system for residential mortgage loan originators (MLO) was born.

The stated purpose for the creation of the MLO system was as follows:

- To aggregate and improve the flow of information between regulators.
- To provide better accounting records and tracking systems of licensed mortgage professionals to make sure that they are funding loans for borrowers who were “creditworthy” applicants.
- To enhance consumer protection and improve disclosure forms so that borrowers understood the costs involved with their loan *before* the loan funded and closed escrow.
- To improve anti-fraud measures that made it easier for financial agencies to pursue individuals and licensed agents in both civil and criminal courts.
- To offer consumers more clearly written educational information to help borrowers understand their rights.
- To provide a centralized list of details about any past disciplinary actions taken against a licensed mortgage professional that could easily be found by mortgage applicants who were seeking out honest and trustworthy mortgage professionals to assist them.

The SAFE Act prohibited individuals from engaging in any type of residential loan funding for owner-occupants without first having obtained and maintained on an annual basis an MLO license. The license expires on December 31st of each year. There is both a federal and state registration process involved with the MLO license endorsement system that is handled through the **Nationwide Mortgage Licensing System and Registry**.

Salespersons and real estate brokers with active real estate licenses may also engage on the mortgage finance side of the business in certain cases. Back before the Dodd-Frank Wall Street Reform and Consumer Protection

Act² led to the creation of the Consumer Financial Protection Bureau (CFPB) in 2010, a person holding an active salesperson or broker's license in the state of California could also work as a part-time or full-time mortgage broker or mortgage banker without needing to hold another separate mortgage license.

In California, there are **two separate types of MLO categories** that a person may be required to hold if they plan on funding certain types of owner-occupied residential loans as required by the **Secure and Fair Enforcement Licensing Act of 2008 (SAFE Act)**.

These license categories consist of the following:

- 1) **Federally registered MLO licenses:** This license is offered to people who work for federally chartered banks, credit unions, or other types of federally-regulated financial entities.
- 2) **State-licensed MLOs:** This MLO license designation is required for people employed by state agencies or institutions.

In California, there are **two state agencies that regulate state licensed MLO license holders** separately:

- 1) The **California Department of Real Estate (CalDRE)** which issues MLO endorsements to real estate licensees as provided for under the California Business and Professions Code §10166.02(b); and
- 2) The **Department of Business Oversight (DBO)** which issues MLO licenses under the **California Finance Lenders Law (CFL)** and the **California Residential Mortgage Lending Law (CRMLA)**

2

On March 14, 2018, the Senate passed the [Economic Growth, Regulatory Relief and Consumer Protection Act](#) exempting dozens of U.S. banks from the Dodd-Frank Act's banking regulations. On May 22, 2018, the law passed in the House of Representatives. On May 24, 2018, President Trump signed the partial repeal into law.

partly under the authority of the California Finance Code §§22100(a), 50120.

All individual MLO license holders are required to register with the public federal database that is called the **Nationwide Mortgage Licensing System (NMLS)** upon the completion of passing their exam, paying their annual fees, and being accepted to qualify. In addition, California MLO license holders are required to follow state licensing and use requirements that are unique to California.

An applicant for the MLO license in California must meet certain minimum standards first, complete pre-licensing education requirements, and pass both state and federal lending exams. Every year after receiving the MLO license, a California MLO licensee must complete continuing education courses and pay fees to maintain his or her active California MLO licensing status for the state and federal registration system.

For individual MLO licensees who may be employed directly by a federally chartered financial institution such as a big bank like Wells Fargo or Chase, they are still required to meet minimum standards to qualify for the MLO license. This is the case even if they are employed and paid a salary directly by the federally insured financial institution. However, they do not usually need to complete pre-licensing or continuing education requirements to first obtain or renew their federal registration status.

Federally registered MLO: Prior to the registration as a federally registered MLO license holder, one must first find a job with a federally regulated financial institution as some type of consumer or residential loan officer. If the person who applies for a new job at a federally insured bank does not already hold an active MLO license or have any sort of NMLS ID (Nationwide Mortgage Licensing System), the employing bank will create an account for the new loan officer that lists them in the NMLS registry.

The MLO licensee who is registered as a federally registered employee of a big bank or another type of federally-insured financial entity will be required to renew their registration each year during the annual two month window of time provided in November or December. It is up to the bank to ensure that their MLO employee keeps up to date with the most recent information for the NMLS registration system. This is a mandatory federal law as partly outlined in 12 Code of Federal Regulations §1007.104.

State-licensed MLO: For a more independent MLO loan officer who works in California with multiple lenders, he or she is required to hold a CalDRE endorsement for their state-licensed MLO designation. In addition, the California MLO applicant must also hold an active CalDRE real estate license under the California Business & Professions Code §10130.

There are several different types of MLO endorsements and license status options issued by CalDRE which include: 1) individual salesperson endorsements; 2) individual broker endorsements; 3) brokerage company endorsements; 4) brokerage corporation endorsements; and 5) brokerage branch office endorsements.

With a state licensed MLO endorsement, a person may conduct the following types of business transaction in California:

- Mortgage brokering (owner-occupied residential loans, especially)
- Mortgage loan servicing
- The negotiation of mortgage loan modifications (i.e., assist with modifications to monthly mortgage payments and loan terms)
- Short-sale negotiations between the lender, borrower, and new buyer

A real estate sales agent licensed under CalDRE may only make and arrange mortgage loans on behalf of his or her employing real estate or mortgage broker if and when **both** the salesperson and the employing

broker hold individual MLO endorsements in accordance with 10 California Code of Regulations §2756.

How often does a license for MLO need to be renewed?



The MLO Steps in California

The DRE uses the **Nationwide Multistate Licensing System (NMLS)** to supervise, regulate, and manage all MLO licensees and their respective endorsements. Any new submissions made by MLO applicants or any future changes made to MLO records such as a new place of business must be submitted electronically through the NMLS system. Any information submitted to NMLS is required to be identical to the same records provided to CalDRE.

To qualify to apply for the MLO license endorsement from CalDRE, the applicant is required to hold an active real estate license the status of

which must be “current” with the DRE. Any applicants with a license status of “expired,” “suspended,” or “revoked,” will *not* be approved for the MLO license endorsement. When renewing an active MLO license each year, the same person must continue to hold an active real estate salesperson or broker’s license before his or her MLO endorsement status will be renewed.

Individual MLO License Endorsement

An individual salesperson, broker, or broker/officer of a licensed corporation who is interested in working as an MLO licensed professional will need to first file an individual **MU4** form through NMLS prior to obtaining his or her **Individual MLO** license endorsement.

The main steps in the online application process for Individual MLO license candidates is as follows:

- 1) Create an account in NMLS and receive a unique NMLS ID number.
- 2) Pass the national SAFE Test which includes the Uniform State Content.
- 3) Complete 20 hours of pre-licensure education requirements.
- 4) Send in the Individual (MU4) form electronically and pay the requested fees.
- 5) Provide fingerprints to the NMLS for background checks during the application review process.
- 6) Send in a submitted authorization form that gives the NMLS permission to review the applicant’s personal credit report history.
- 7) Give access to the MLO candidate’s employing company for an approved or active MLO license endorsement. That same company will also have to request sponsorship allowances before the MLO endorsement is issued in an “Approved” status. This is because a

salesperson with an MLO designation must have a qualified MLO-approved sponsoring broker who employs them, just like a real estate salesperson needs to find a broker to place their license under before they begin working as an active real estate agent. Without the brokerage sponsorship in place for the newly licensed MLO salesperson, the Individual MLO license endorsement will be issued in an “Approved-Inactive” status.

Company MLO License Endorsement

For an individual broker working as a **sole proprietor** (in a single-person office or a much larger office with multiple salespersons) and who acts as a residential MLO licensee, he or she must file a company MLO form (**MU1**) and a separate individual form (**MU4**) electronically through the NMLS system to receive an active company MLO license endorsement.

Any brokerage firms acting as a **corporation** must also file a company form (MU1) and an individual form (MU4) for the main designated broker/corporate officer electronically through NMLS prior to getting a new company MLO license endorsement.

To obtain a brokerage firm’s **branch office** designation for the MLO license, a branch form (**MU3**) must be filed electronically through NMLS when that office is engaging in the practice of providing owner-occupied residential mortgage loans to the public. The MU3 form should include a new address that is different from the main office address for the brokerage firm that is already on file with CalDRE. The branch office address that is submitted on this application form must be an actual physical address as opposed to a P.O. box. At this address, the MLO business must be conducted by the individually designated MLO salespersons and brokers who are also approved by the DRE.

The 20 hours of pre-licensure courses that are now required to be completed after the passage and enactment of the SAFE Act for MLO applicants includes these NMLS-approved courses:

- 3 hours of federal laws and regulations
- 3 hours of ethics (fraud, consumer protection, and fair lending issues)
- 2 hours of training related to non-conventional mortgage products
- 12 hours of additional instruction on mortgage origination

The 20 hours of pre-licensure education does not have to be completed before applying to take the National SAFE Test with Uniform State Content. However, all the required educational courses must be completed before an endorsement application is submitted.

Commercial Brokerage

Mortgage professionals who are exempt from holding an active MLO license are individuals who focus on offering private money or certain types of institutional funds that are used to acquire non-owner occupied residential properties (one-to-four units), land, and any and all types of properties that are classified as commercial real estate. Commercial mortgage brokers can assist individual or corporate landlords who own one or more types of commercial properties such as large apartment buildings, mini-storage facilities, and retail strip centers. Or they can assist (usually corporate) landlords that own much larger regional shopping centers with large and prosperous tenants (like big-box retailers such as Walmart, Target, or Best Buy) as their primary “anchor” tenants (or the main tenant bringing in traffic to the center) .

Some mortgage brokers today without an active MLO license will on work on non-owner occupied residential loans and they may also work on some commercial loans. There have been some incredibly lucrative investment opportunities for new and experienced real estate investors who focus on

acquiring, fixing up, and quickly reselling (or “flipping”) the properties to new owner-occupant buyers or to other investors. Some of the best customers that mortgage brokers, with or without an active MLO license, can find to work with on several transactions over many years are these same “fix-and-flip” investors because they typically turn property over quickly and often.

Often, the fix-and-flip investors have a relatively short period of time to close escrow on a purchase deal for a property being sold well below market value by a lender or motivated property owner who may be facing near-term foreclosure filing risks due to months of missed mortgage payments. In deals like these, the buyer for the subject property might be competing with multiple investors to pick up the property for a relatively small fraction of the true current market value in “as is” condition or after the investor spends a few weeks improving the property with some touch-up paint, new landscaping, flooring, and window coverings.

When time is of the essence and the mortgage borrower/investor only has a week or two to close escrow, he or she does not have much time to go through the traditional conventional loan process that might take 30 to 60 days. The borrower may gladly accept a private-money loan that is priced 2% or 3% higher than the best conventional loan being offered at the time because he or she plans to hold the loan for only a few months until they sell it to a new buyer. Sometimes, the profit gains can be \$100,000 or more for a few months’ worth of work for the investor, so he or she will be more open-minded about paying the mortgage broker two or three points (2 - 3%) on the funded private-money loan as long as they close the loan as quickly as possible. One or two consistent “fix-and-flip investors” can generate several mortgage loans if they are buying and selling properties every few months.

The most important part of the determination as to whether a licensee needs to hold an active MLO license endorsement is whether he or she is providing owner-occupied residential loans to the borrower. The stated primary purpose of the creation of the MLO program was to better protect

homeowners from the potential of losing their home to foreclosure due to bad loan choices offered to them by their inexperienced or greedy mortgage loan professional.

Commercial mortgage brokers tend to look closely at the current or past income history associated with the subject property as well as the financial strength and creditworthiness of the borrower. If the property does not provide sufficient amounts of cash flow, then most lenders will likely consider the property too risky and not be interested in offering the loan to the mortgage applicant.

One of the main mortgage underwriting formulas that commercial mortgage loan brokers use to determine whether or not a property qualifies for a new purchase or refinance mortgage is something called the **Debt Service Coverage Ratio (DSCR)**. Let's discuss a DSCR for a commercial property like an office building or retail strip center.

The DSCR is the relationship of a property's annual net operating income (NOI) to the subject property's annual mortgage debt service payment obligations (principal and interest). It is similar to a debt coverage ratio formula used when mortgage processors and underwriters try to decide if a mortgage borrower has enough gross monthly income to cover the proposed mortgage payment and still have enough money left over to cover additional monthly debt obligations and any unexpected costs.

Let's review this example using the DSCR formula:

An office building has an annual net operating income of \$125,000.

It has a current or proposed annual mortgage payment (principal and interest) obligation of \$100,000 each year.

The Debt Service Coverage Ratio is calculated as follows:

- $\text{NOI divided by debt service} = \text{DSCR}$ (or $\text{NOI/Debt Service} = \text{DSCR}$)
- $\$125,000/\$100,000 = 1.25$

A lender would describe this office building as having a 1.25 Debt Service Coverage Ratio. A break-even ratio would be a 1.0 DSCR. Lenders, obviously, want the DSCR numbers to be much higher than break-even because they want the property owners to have enough cash leftover after collecting all of the rents and paying their expenses to also be able to afford their mortgage payments. Some lenders may require a minimum of a 1.25 DSCR while others might demand higher numbers above 1.35 or 1.40.

Some commercial loan transactions can range from \$5 million to \$100 million or more for larger prime office buildings or construction projects. If a commercial mortgage broker is fortunate enough to fund a loan this big and only collects a gross fee of 1% of the funded loan amount, the commission he or she collects may range from \$50,000 (1% of \$5 million) to \$1 million dollars (1% of \$100 million). With commission possibilities this high, it only takes one or a few good-sized deals for the commercial loan broker to generate income revenues that will place him or her into the top income earning brackets nationally.

To scout commercial loans, mortgage loan professionals and real estate agents who specialize in the buying, leasing, and selling of commercial properties can visit the property or business owners in person and hand them their business cards or flyers to promote their best mortgage loan products. In addition, commercial loan brokers and real estate agents can offer property owners free value analysis spreadsheets which show the owners the latest building values and rental payment trends for similar properties in the area.

Prospects, customers, or existing long-time clients who consistently receive updated market analysis information that helps to keep them informed about the market trends, tend to become loyal customers at some point down the road if and when they are later ready to buy, sell, or lease.

On-Site Tract Sales



In recent years, California has experienced an incredible shortage of affordably-priced homes and apartments to buy or lease. Over the past 10 to 15 years, the number of new homes and apartment units has dwindled down to numbers well below historical averages.

New home production has averaged less than 89,000 new housing units over the past 15 years. The year 2016 was the best in terms of new home construction in California, as compared with years dating back to the official start of the Credit Crisis in 2008. With so many millions of foreclosed homes across the nation between 2006 and 2010, few builders or construction lenders wanted to take the risk of attempting to build new housing tracts or apartment buildings.

The years 2010 and 2011 were two of the historically *worst* years for new construction in California. According to the California Department of Finance, there were only about 36,000 new homes constructed in 2010 and 2011. 2013's numbers began to move above 56,000 housing units, and 2014 and 2015 headed closer to approximately 70,000 housing units

in each year.

Even though 2016 reached 88,562 new housing units built, these numbers were still less than half of where they should have been to keep up with the demand at that time. According to the California Department of Housing and Community Development and its close review of population trends, rent prices, and other economic data, there should have been at least 180,000 new housing units built each year to keep up with the demand at that point. Factors such as the annual size of the California population base increasing by over 334,000 new residents in just 2016 alone caused the demand to go way up. The comparison of new homes built to the influx of new residents to the state equates to about one new home being built for every 3.78 new residents.

However, although the state's population has continued to grow, the growth rate has slowed down substantially over the last few years. The years 2017 through 2020 have seen declines in the growth rate. According to Macrotrends, which collects population data from the Census Bureau, in 2016, the state's population grew from 2015 by .64%. In 2017, it grew by .49%; in 2018, .26%; and in 2019, it grew by only .13%. It appears that the population is leveling off. Prior to the slow down in population growth, the number of building permits issued (the first major step in the home subdivision building process) had consistently increased year-over-year through 2017. A recent report that was jointly issued by the U.S. Census Bureau and the U.S. Department of Housing and Urban Development (HUD) showed that building permits increased 8.3% in August 2017 as compared with the same time one year prior. But in 2018 through 2020, the number of building permits issued has fallen, albeit only slightly. Builders still continue to build, and people still continue to buy.

In 2020, there were somewhat fewer homes on the market in general than 2019, including both new construction and existing homes. That has caused prices in California to remain high as buyers compete for the shorter supply.

With economics and the sale of any consumer goods or services, a short supply of any product coupled with a steady demand from customers usually causes sales to increase at a rapid pace along with a steady increase in prices. One of the most rewarding real estate agent opportunities out there today for new or experienced agents or brokers is associated with working as an on-site salesperson for new subdivisions. Some of the larger master-planned community neighborhoods may consist of hundreds or thousands of homes that are built over a period of several years that can keep an on-site salesperson busy for a long time.

Agents who work as the main salespeople for on-site subdivision tracts for single-family homes, condominiums, and townhouse projects do not usually have to worry about paying for any advertising costs in order to attract buyer prospects to come out to visit them. Some of the largest real estate developers are publicly-traded corporations with market cap values well above a few hundred million or several billion dollars. These wealthy corporate entities then may have hundreds of thousands to millions of dollars available to advertise and promote their new home communities by way of television, radio, print media, and online marketing methods.

If the builder's employment contract allows it, the salesperson may be able to keep and maintain a running list of buyer prospects who walk through their sales office each day of the week. For buyers who did not decide to buy from the builder, the salesperson may have the right to contact them at a later date to show them other properties either being developed by the same builder or some older homes. Or, the agent may be able to refer these buyer prospects out to other real estate agents in the area for 25% referral fees, if allowed by their employment contract with the builder.

Usually, an employing builder will not pay a full 3% selling commission fee to their employed on-site salespersons. Even if the employing developer pays only a 1.5% to 2% commission to the on-site salesperson for each property sold, the annual income potential can be staggeringly high due to the high number of property closings on a monthly basis and

the much higher average selling price for new home developments in California. Often, the builder might even pay advance fees (or early “draws” against future commissions) to the salesperson during the early construction phases before any homes have their final Notices of Completion permits in place so that the salespeople have some steady income throughout the entire project.

For example, a new home community with 400 houses being built over a period of two years has an average home selling price of \$600,000. Let’s say that there are two main salespersons working the site six or seven days per week over the next two years, and that each agent is listed as the selling agent for 200 of the homes, each at an average selling price of \$600,000 that generates a 2% net commission to each agent. A 2% commission paid from a \$600,000 home sale equals \$12,000 commission per unit ($\$12,000 \times 200$ units for each selling agent = \$2,400,000 in commission fees payable over two years or \$120,000 per year in annual income per on-site salesperson). Remember, the on-site salesperson does not usually have to worry about paying their own advertising or office expenses, so these commissions are almost pure profit to the selling agent.

The builder will probably pay 3% or slightly below to buyers’ agents who bring in prospects to buy their properties. There are also opportunities for on-site agents and other real estate licensees to specialize in bringing new prospects or long-time clients to other development projects in the area. A buyer’s agent who consistently shows up to builder subdivisions with “ready, willing, and able” buyers who can quickly close escrow may later be contacted by the real estate developer for a job working on-site for them in their next project down the road that is much larger with 1,000 new housing units!

Chapter Two Summary

- An agent is a person who has been appointed by a **principal** (also referred to as a client or customer) to represent him or her in dealing with **third parties**.
- The **rules of agency** apply to relationships between agents (brokers and salespersons) and principals, and between agents and other agents. **Buyer's agency** and **seller's agency** (list brokers) are types of **single agency relationships**, while an agent who represents two sides in one deal is engaging in a **dual agency relationship**.
- Salespersons act as **independent contractors** when working under a broker's license, especially if they receive the bulk of their income from commissions. Those agents will file their tax returns as **self-employed** individuals.
- An agent acts as a **fiduciary** when working with his or her clients; a fiduciary relationship is one built upon a position of trust. The agent must show his or her client the utmost care, obedience, accounting, and loyalty, and must disclose material facts (**COALD**) as part of their agency duties.
- Commission amounts are fully negotiable between the employing broker and his or her agents. The **commission splits** will usually begin at lower rates like 50/50 before the employing broker later raises it to a higher rate of 60/40 (60% to the agent and 40% to the broker), 70/30 and 80/20 splits after the agent closes more deals on a fairly consistent basis.
- **Commission disputes** between two or more agents or brokers can be resolved by way of arbitration, mediation, lawsuits, and the Labor Commissioner's office.

- The rules began to change tremendously for mortgage brokers who worked primarily on owner-occupied residential purchases or refinance mortgage loans beginning in 2008 after the **SAFE Act (The Secure and Fair Enforcement for Mortgage Licensing Act of 2008)** was enacted.
- State and federal **MLO (Mortgage Loan Originator)** license endorsements were required for most mortgage professionals after the passage of the SAFE Act. The one-year license expires by December 31st each year.
- All MLO license holders must register with a public federal database that is called the **Nationwide Mortgage Licensing System (NMLS)**. The **Department of Business Oversight (DBO)**, which issues MLO licenses under the **California Finance Lenders Law (CFLL)** and the **California Residential Mortgage Lending Law (CRMLA)**, is in charge of state licensing requirements for mortgage brokers.
- There have been fewer new homes constructed across the state over the last few years. And California's population has seen a slowdown in growth since 2017.

Chapter Two Quiz

1. Who appoints an agent?
 - A. Broker
 - B. CalDRE
 - C. Principal
 - D. Commissioner

2. Who is generally paid primarily with commission income?
 - A. Salaried employee
 - B. Independent contractor
 - C. Salesperson
 - D. Both B and C

3. Who acts as a fiduciary?
 - A. Principal
 - B. Salesperson
 - C. Broker
 - D. Both B and C

4. Which answer below is *not* part of COALD as it relates to agency duties?
 - A. Conversion
 - B. Obedience
 - C. Accounting
 - D. Loyalty

5. Agents who mix client funds with personal funds are engaging in the act of _____.
 - A. Conversion
 - B. Commingling
 - C. Omission
 - D. Profit sharing

6. In which forum below will it probably take the longest to resolve commission disputes?
- A. Arbitration
 - B. Mediation
 - C. Court
 - D. Labor Commissioner's office
7. What is the maximum dollar amount that a person can seek in Small Claims Court in California?
- A. \$5,000
 - B. \$10,000
 - C. \$15,000
 - D. \$20,000
8. When was the SAFE Act passed?
- A. July 30, 2008
 - B. June 30, 2009
 - C. January 1, 2010
 - D. January 1, 2012
9. How often does a license for MLO need to be renewed?
- A. Every four years
 - B. Every three years
 - C. Every two years
 - D. Every year
10. To act as a mortgage broker for owner-occupied residential loans in California, which license must a person hold?
- A. Series 7
 - B. Real estate license
 - C. State-licensed MLO
 - D. Both B and C

11. Which license is required for California individuals who are employed directly as salaried loan officers for a big bank?

- A. Salesperson license
- B. Federally registered MLO license
- C. State-licensed MLO
- D. No license required

12. What kind of license does a mortgage broker need to keep active when working on a loan for a commercial property?

- A. Broker's license
- B. Federally-registered MLO license
- C. State-registered MLO license
- D. No license required

Answer Key:

1. C	6. C	11. B
2. D	7. B	12. A
3. D	8. A	
4. A	9. D	
5. B	10. D	

CHAPTER 3

MARKET STUDIES AND NEW CONNECTIONS

Overview

Prospecting for new clients is like prospecting for gold. The great state of California joined the Union shortly after the start of the Gold Rush. The origin of the state's nickname as the "Golden State" dates back to how so much wealth was created from the millions of ounces of gold deposits found near Sutter's Mill. Few states in the nation have created more wealth for agents and investors than California's golden real estate sector. This chapter will address how agents can most effectively prospect and connect with new customers while creating golden opportunities for both parties with valuable real estate.

California's New Gold: Real Estate

In the 20th and 21st centuries, the figurative "gold" that created more wealth than any other investment option has been real estate. Few other types of investment opportunities have grown in value than certain coastal properties that increased in price from \$10,000 up to several million over the span of several decades. Investors who are seeking to build up their family's overall net worth tend to rely on the assistance of licensed real estate agents to guide them.

For agents, on the other hand, the discovery of a creditworthy and financially strong client can be akin to their own discovery of a gold mine. Some clients may end up being loyal to the same agent over a period of years or decades. In addition, these same loyal clients can be some of the agent's best sources of referrals for other new clients after the satisfied

clients tell their friends, family, and coworkers about how wonderful the agent has been to them for the past several years.



The real estate profession is really more of a **relationship profession** than a type of business built upon the buying, selling, and leasing of inanimate objects like homes, apartment buildings, or other properties. Agents need to quickly build trust and rapport with their clients or prospects before they later formally establish their agency relationship. If the prospect does not enjoy spending time with the agent because he or she thinks that the agent is rude, untrustworthy, dishonest, or unprofessional, then the agency relationship is unlikely to be established.

In real estate, the agent is really selling himself, first and foremost. As such, he or she must be likeable, well dressed, courteous, a fantastic listener, knowledgeable of the latest market data trends, and a pleasure to be around.

Sphere of Influence



When most real estate agents start out in the business, they do not have vast amounts of money to spend on hiring advertising firms as a way to find their first few clients. For real estate agents, perhaps the most important transaction they ever work on is the very first one that closes escrow and provides them with their first commission check. Since most agents do not get paid with base salaries from their employing brokers, the agents must learn to work as effectively as possible in order to find and close their first few deals.

Without a few thousand dollars to spend on newspaper advertising, color marketing flyers or postcards that are mailed out to thousands of prospects, or a sufficient budget to purchase 100,000 email lists of people who have not “opted out” of email-spam marketing campaigns, a new agent normally begins with word-of-mouth and close family and friend connections. The “sphere of influence” that each agent has in his or her personal and business life is one that can be the “golden ticket” to a long and prosperous real estate career if he or she is willing to tap into those connections.

The contact list that a new agent can create for his or her personal sphere of influence marketing campaign might include both real world and digital world connections such as the following:

Real World Connections

- * Family
- * Old elementary, high school, and college friends
- * Past co-workers at any place of business dating back to teenage years
- * Friends and acquaintances from church, synagogue, clubs, or the gym
- * Children's parents at school
- * Neighbors

Digital World Connections

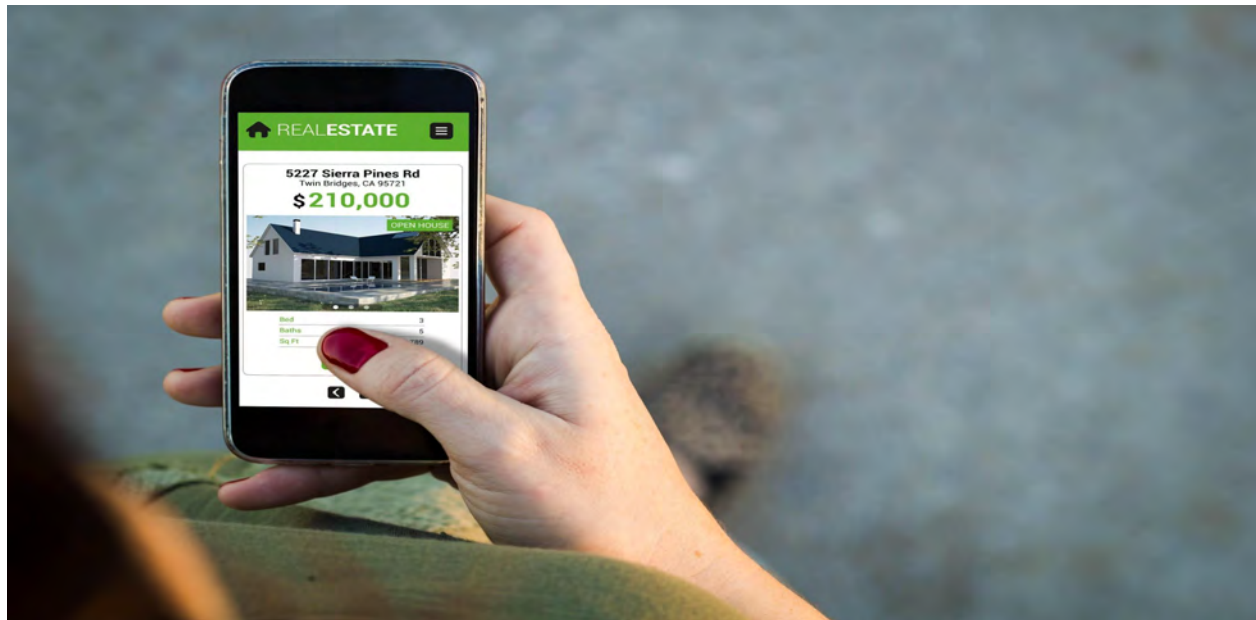
- * Facebook Friends
- * LinkedIn connections
- * YouTube (and Vimeo for videos)
- * Google +
- * Pinterest
- * Instagram
- * Twitter

With respect to marketing, a campaign is only as good as the selected target audience. For someone selling children's clothing, they will probably have more success if they post their articles and website links in groups dedicated to children's fashion in various social media groups. There are now so many groups on Facebook, LinkedIn, and Google+ that have hundreds of thousands of members, each with a shared common interest in the group's topic posted on the top of the group page. For real estate agents seeking buyers in the Southern California region, they might want to consider posting their blog articles in various group pages connected to Southern California such as travel, golf, church or synagogue, family, and tenant sites.

In the old days (or before the mid-1990's) before social media was created, real estate agents probably had just 100 or so potential prospects who they mailed out flyers or postcards to each month or just once a year. Today, an agent has the option to directly or indirectly reach out to some portion of the three plus billion internet users around the world.

Because California attracts real estate investors from many parts of the world such as Asia, Europe, South America, Canada, Mexico, and other places, it can make a great deal of sense for California-based real estate agents to create marketing campaigns that target prospects in China, Japan, Canada, and Mexico, especially. There are sites like *Google Translate* that can quickly translate an agent's marketing material from English to another language within seconds.

Listed below are the most-visited social media sites in the world as of December 2020, per *Statista*. Please note that most of the websites are based in California and China, and that the highest amount of money spent on a broker's marketing budget is usually for some form of online advertising.



Top Social Media Sites by User (October 2020)

These numbers are estimates and have likely grown since publication.

Facebook: 2.7 billion users
YouTube: 2 billion
WhatsApp: 2 billion
Facebook Messenger: 1.3 billion
WeChat: 1.2 billion
TikTok: 689 million
Instagram: 1.16 billion
QZone: 517 million
SnapChat: 433 million
Reddit: 430 million
Pinterest: 416 million
Tumblr: 368 million
Twitter: 353 million

Source: *Statista* 2020 <https://www.statista.com/statistics/272014/global-social-networks-ranked-by-number-of-users/>

Agents should consider beginning with the people closest to them in their personal “sphere of influence” circle. The inner circle usually consists of the closest family members and friends. It may help a new agent become more confident with the sales techniques by first practicing with people with whom the agent is closest. If the agent’s sales techniques are not as effective as they could be when they start with their closest family and friends, then the family and friends can politely offer tips and encourage them to work on their sales strategies.

From this inner circle, the agent can then ask them if they know any friends or family in need of real estate services. If so, this circle of influence will continue to grow from “friends of the agent” outward to the “friends of friends of the agent” and so on like a ripple after someone throws a rock into the calm water. From there, it may continue to expand

outward until the agent's contact database grows to 1,000 or more contacts within a relatively short period of time.

Under a \$200 Marketing Budget

Agents must be courteous when attempting to reach out to new customers and not invade their personal space. For example, even though it may be acceptable to make door-to-door prospecting calls up until 10pm, most people may think it is rude if done after 7 or 8 pm.



In addition to speaking with a prospect in person and shaking his or her hand at no charge when trying to expand the agent's marketing circle, here are some other marketing ideas that cost less than \$200:

* **Business cards:** The agent can hand them out to people at church, mosque, synagogue (or other places of worship), in grocery stores, at school functions, and to his or her neighbors.

* **Flyers:** Agents can make photocopies of a one-page flyer that promotes their services. If the broker does not limit each agent from making too many color copies, then the agent might just need to pay for some extra white or colored paper. If there are restrictions on making too many copies at a broker's office, then there are options to print them out at home or at a nearby postal service or franchised computer office space location for a few cents per page.

* **Personal advertising:** Business cards, magnetic car signs that are placed on the agent's car door, and other types of creative marketing methods can help build name recognition for the agent.

* **Create a website or a blog:** Companies like *GoDaddy*, *Blogger*, and *WordPress* may offer new website domain names and blog spaces for a relatively small amount of money. In fact, some URL domain names can be purchased for prices as low as under \$10. With a new website or blog that is designed to look like a \$5,000 website at a price of less than \$70 per year, the agent may include the name of his or her new website on any business cards and flyers that he or she hands out around town. *Blogger* is owned by Google, so many of its *Blogger* sites may appear towards the top of any online search list. The use of *Blogger* sites that can be set up for free in many cases can be an invaluable marketing tool if used correctly.

* **Create a video:** An agent can create their own *YouTube* or *Vimeo* page for free. Under the video image, the agent will list their contact information, broker's license details, and any website and blog links for

interested parties to visit. Video examples might include a new home listing that another agent has in the office with both interior and exterior images. The main purpose of the video is so that the new agent can hopefully find a new buyer prospect to purchase this listed property or another property nearby.

Most prospects like to learn something new that they consider to have some value and benefit for them. To create loyal prospects who will continue to visit the agent's new blog or website, the agent should update the content as much as possible prior to also sharing their website link all over social media for no extra charge. The latest statistics and data provided by an agent on their blog or website can also make the agent seem very knowledgeable and informed about the area to prospects thinking about hiring a new agent.

As we have discussed, for most Americans, the equity in their main home where they reside represents the largest percentage of their overall net worth. Thus, an agent who provides weekly or monthly price updates of homes in neighborhoods that surround their prospects will keep them coming back each week or month to find out if their family's overall net worth went up or down. If and when a prospect is ready to sell their home, they may likely remember that agent who keeps them up to date with the latest price trends and give that agent the listing.

Some people have hundreds to thousands of Facebook friends in many parts of the world. An agent who shares links to his or her latest blog article might later see them shared again and again by their friends, friends of friends, and so on all over the world. Instead of spending \$1,000 on stamps and another \$3,000 on professional postcards, the agent can create digital versions of flyers, postcards, blogs, and websites for prices as low as \$0!

As time moves forward and the agent is able to set aside more money for their marketing budgets, then the agent can explore creating even wider reaching marketing campaigns in both the real world and the digital

world. Younger people under the age of 50 may be more responsive to internet marketing while marketing surveys show that older consumers over the age of 50 still prefer classified ads. For new listings, the agent's marketing plan presentation to the client should show them what types of advertising methods will be used to market their property.

24-Hour Response Time: A customer or prospect who contacts the agent by phone, email, or sees them somewhere in person should be responded to either within the same day or within 24 hours, if possible. While the prospective client is still very interested, the agent should try to schedule an appointment with him or her at the office, at the client's home, at a coffee shop or some other public setting, or at a property that interests that potential client.

In situations where the caller for a listed property refuses to give his name to the agent, the agent should still offer useful information about the property partly as a strategy to keep the caller on the phone longer in hopes that the caller will later offer his contact information and meet in person.



Powerful and Influential Selling Methods

Dale Carnegie, the well-known motivational and sales technique mentor, used to teach his students that they must find out what best motivates the prospect in front of them before later developing a sales strategy that is built around the client's needs and interests. With any sales transaction, it should go without saying that the needs and interests of the client are much more important than those of the agent. Carnegie used to say repeatedly to his students that "you must build the sales presentation around exactly what the client is seeking."

One of Carnegie's best-selling techniques was called the "**Fact, Bridge, Benefit**" rule of sales. To truly understand what the prospect or client is seeking or really needs, the salesperson must be an empathetic and attentive listener. The agent must ask a lot of empowering questions of the prospect in order to find out what the client really wants to achieve when working with the agent. Agents should learn to read body language such as when the other party sits with arms open (crossed arms and legs are a potential sign of closed-mindedness or displeasure), smiles, leans forward while sitting and reaches for the contract to review and hopefully sign.

A client who dreams of buying a \$1 million dollar home near the beach, but only has a pre-qualified mortgage letter for a \$300,000 home is one who has dreams that currently exceed their reality. In a perfect world, the agent will close escrow with the client this month on a \$300,000 home, and later find her a \$1 million dream home after her income levels reach high enough to qualify for a property in that price range.

In this scenario above, the agent keeps asking questions like "Do you have a pre-approval mortgage letter that qualifies you for a specific price range?" If so, the agent should ask for a copy of the letter, and even consider calling the mortgage broker or loan officer at the bank to find out exactly what the true down payment, monthly payment, and loan term options are available to the client. Once the questions of pricing and

qualification are addressed, then the agent can ask the client about their desired neighborhood choices as well as why they are interested in that specific neighborhood, zip code, region, town, or city.

Sometimes, buyer prospects will be influenced by the short commute to work, the school choices, or the proximity to parks, beaches, golf courses, or mountains when deciding where they actually want to live. If the prospect has a 6-year-old child who they would like to attend school at one of the best schools in the county or state along with some other family members or close friends, then this one factor may be the main reason why the prospect wants to buy a home in this neighborhood instead of another one just a mile away.

Once the agent understands the primary influence or reason that is driving the prospect's need to find a new home before the end of the summer, then he can build his presentation to the client this way by following Dale Carnegie's "fact, bridge, benefit" selling strategy.

Fact: The client qualifies for a \$300,000 home, and prefers to buy a home near the Arrowhead Elementary School for her 6-year-old daughter. Again, the agent only knows what the client is searching for after asking her a series of open-ended questions that helped inspired the prospect to share the true reasons why they want to buy the home and why it must close escrow before the next school year begins in the first week of September.

The agent will then find a property that meets the client's primary needs and interests. The agent, in turn, will use the fact, bridge, benefit selling technique as follows when making his or her sales presentation prior to the client writing up a purchase offer:

Agent: This home on Crescent Street is listed for sale at \$325,000. But I think that the seller might strongly consider a \$295,000 purchase offer because the sellers are in the midst of a nasty divorce and are eager to close escrow as quickly as possible prior to dividing up the shares

between the husband and wife. The property is located just one block from the Arrowhead school. Because the school year starts on September 3rd, I think that we should write up the purchase contract with a target closing date of August 15th. I think that two weeks of living in the property should help you and your daughter get all moved in and decorate the house with enough time before the school year begins. (Note: the agent is stating the main **facts** related to what the client is seeking).

Bridge: The bridge in the Dale Carnegie sales strategy is using a clause such as “which will allow you to . . .” that connects the fact and benefit together to complete the sales presentation. It is a way to show the prospect how their facts will merge with their desired benefit in a way that is somewhat akin to crossing a literal bridge over a river.

Benefit: The explanation of the benefit is just a restatement of how this transaction will allow the client to find his or her true needs and interests.

In summary, the agent’s final push to inspire the client to write up a purchase offer today (instead of tomorrow) by using the **Fact, Bridge, Benefit** strategy is as follows:

*“The home on Crescent street can be purchased for under your qualifying amount of \$300,000 and is located just one block from the award-winning Arrowhead School. The sellers are motivated to close quickly, so they should agree to accept our 30-day offer to purchase for a scheduled closing date of August 15th **which will allow you to (bridge)** move into the home, get unpacked and fully decorate your home, and give you enough time to enroll your daughter in school before the school year begins. And the home is at a purchase price that you easily qualify for according to your mortgage broker.”*

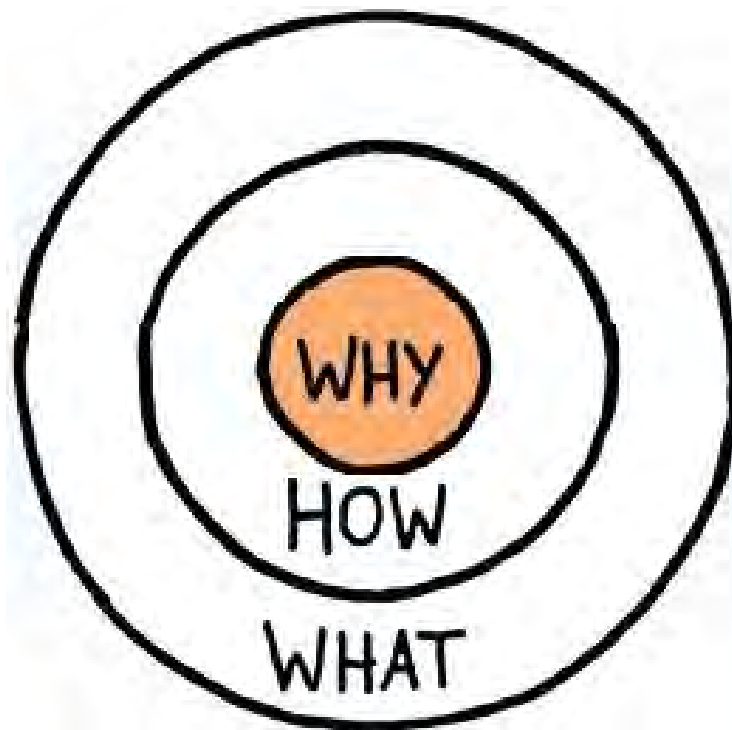
Some of the key steps in Carnegie’s selling systems that have been followed by many of the most successful real estate and mortgage

professionals in the nation over the past several decades include these points:

- 1) Smile: The first impression is usually the most important one.
- 2) Listen: We have two ears and one mouth for a reason.
- 3) Arouse an “eager want” from the clients, talk in terms of their interests and needs, and then provide them with what they desire.
- 4) Call the client by name, show, and explain. For most people, their first name is their favorite word used in their language. It is important to say their name and remember their name at a later date because some people can get quite upset if their agents don’t remember meeting them.
- 5) Avoid arguments with the client. Be respectful of the other person’s wants, needs, and points of view. One of the quickest ways to lose a client is by telling them that they are wrong.
- 6) Let the clients sell the product to themselves. Most people do not want to be told what to buy. It is up to the agent to show the client multiple properties that may interest them before letting the client make the final decision.
- 7) Be enthusiastic from start to finish with the client. Dale Carnegie used to preach that enthusiasm was the most important component in the selling process. The agent must be excited about the product, service, or property that he or she is selling. From the client’s perspective, an agent who is excited and enthused about something must mean that it really is a great deal for them too.

There is another more current sales book that is entitled *Start With Your Why* by Simon Sinek that makes several points similar to Dale Carnegie’s. The author describes a method he calls “The Golden Circle” that consists

of three short questions: *Why? How? What?* If one were to visualize these questions on a target like a dart game, it would be the **“Why?”** that is the most important in the center because it represents the prospect or client’s primary **inspiration** for showing up that day. As such, Mr. Sinek asks his readers to “start with why” when working with people in business environments or in sales situations.



Agent: ***“Why** is this client interested in working with me today? **How** may I best assist her? **What** may we both accomplish together?”*

Once the agent hears a client asking lots of questions about the price and the property, the time to possess or occupy it, and continuing to agree or affirm the agent’s statements, the agent must go in for the assumptive “close” by just handing his or her client the contract.

Assessing a Property's Value

Shortly after an agent has developed a solid rapport with a client who wants to sell his or her property, he can then offer the client (or prospect) some updated price trends for similar properties close to the property owner's home as a free service. Or, if the new client (or prospect) is looking to buy a home or condominium in a certain target neighborhood, the agent can provide a list of updated home sale comparables or "comps" to better help the prospect decide to buy or sell.

With most residential properties, the best comps are the ones that are the most similar to the subject property. The **value** of an asset like a home is usually determined by the price that a buyer is willing to pay for that property. Of course, the seller wants to receive the highest price possible while the buyer wants to pay the least amount of money for the property. It is up to the buyer, seller, and their respective real estate agents to find some type of middle ground between the highest and lowest prices so that the deal seems to be a "win/win" for all parties involved.

Under various economic theories of value, let's review some of the more common approaches to the valuation of an asset, consumer good, or service:

Value in use: Valuation may be subjective or in the "eye of the beholder." Sometimes, a person can be quite biased about the value of the home that they have lived in over the past 30 years. To the person selling the home, there are so many wonderful memories that are seemingly priceless to them, and the owner sees very few flaws in the property. The **value in use** is "the subjective value that is perceived or placed on the property by someone who owns or uses it."

*Which party is likely to believe that a certain property type has the highest value potential under the **value in use** theory?*

Value in exchange: The buyer, however, may see an older, rundown home in need of serious repairs and remodel upgrades that might cost the buyer another \$100,000 to complete. If so, then the buyer may offer a price well below the seller's anticipated returns or net price because the buyer expects to spend a lot of money modernizing the older home. The **value in exchange** (or **market value**) is the objective value of a property or potential offering price, from the eyes of an average person who has no bias towards or against the home. The average person has no past, positive memories or experiences with that home.

In spite of the phrases sounding similar, there can be a tremendous difference between **market price** paid for the property and its **market value**. The **market price** is the price actually paid for a property. This can be true in some "all cash" situations when the wealthy buyer loved the property a bit too much, represented themselves without an agent, and paid a price that made very little economic sense because it was \$200,000 above the next best price comparable.

The **market value** is the price that probably should have been paid by a willing buyer under a "fair sale" condition without any adverse or negative factors possibly influencing them to pay too much or sell at a price too low.

The **cost** of a property can be much different than its value as well. It can be the actual price paid to purchase the property plus the true cost paid to fix up the home. For example, a buyer might pay \$32,000 to a contractor to complete a remodel on one room in a newly purchased home. The room remodel could potentially increase the overall selling price of the finished home by \$100,000. Even though the selling price of the home later increased by \$100,000 in a "fix-and-flip" type of sales transaction, the absolute repair costs paid by the owner/contractor were still only \$32,000. So, the \$32,000 **cost** of the remodel yielded a \$100,000 boost in the **value** of the home.



Competitive Market Analysis (CMA)

Before a real estate agent agrees to accept a new listing from a seller, the agent should consider providing the seller with a competitive market analysis that assists the seller and the agent's employer, who is the potential listing broker, to arrive at a fair market price for the listing. In many ways, the agent is acting somewhat like an appraiser when putting together a CMA report for the client, as it helps the agent attempt to establish the property's most current value and the listing price. But a CMA report is not as good or detailed as a full appraisal report completed by a qualified and experienced appraiser. The most effective and accurate CMA reports usually detail sales or listing comps within the past six (6) months of the date of the completed report.

Appraisers are likely to choose one, two, or all three of the following approaches when analyzing a residential or commercial property:

1. Cost approach to value: This valuation method attempts to estimate how much it would cost to reproduce or replicate the same structure elsewhere. The appraiser would then subtract the depreciation (“wear and tear”) for the older property being valued when comparing it with a newer property being built today to arrive at this type of value. **Depreciable basis** in the cost analysis is the value of the improvements (or home structure) made to the land.

2. Income approach to value: An appraiser will estimate the property value based on the income that the property could generate if offered for lease.

3. Sales comparables approach to value: The estimate of property value by comparing one property with other similar properties nearby.

The first two of the three options might be a bit time consuming and complex for some newer or inexperienced real estate agents. With the first cost approach to value estimate option, an agent would probably need to have some type of background related to construction bids, costs, and materials needed. For the second approach that analyzes income potential, the new agent might need to have some property management experience, or property-leasing background before being able to determine what the subject property will likely generate as a rental property.

The third valuation option that is related to the sales comparable method is very similar to the CMA approach. CMAs can be fairly accurate because they can show what an informed and willing buyer who was free of any pressure actually paid for homes recently purchased that are property matches for the subject property about to be listed. Under the **principle of substitution**, a buyer who is given two almost exact properties or products to choose from, is more likely to purchase the property that is

priced lower. Because so many tract homes in California can be identical matches with the exact same bedroom, bath, and square footage numbers for both the home and lot, as well as being built in the same year, a CMA report can be beneficial and fairly accurate when presented to a seller.

The steps involved in the CMA analysis process include:

- 1) Collecting and analyzing information about the seller's home;
- 2) Finding suitable comparable properties;
- 3) Comparing the seller's property to the selected comparable properties;
- 4) Making price adjustments related to the major differences between the subject property and the properties being compared; and
- 5) Determining a realistic listing price for the seller's property that an informed and qualified buyer would be willing to pay.

Agents can find some of the best comparables and current listings by searching through the local **MLS (Multiple Listing Service)**, driving around the neighborhood near the subject property, walking through Open Houses that are similar to the subject property in the same neighborhood , and speaking with nearby agents about the latest market price trends for the area. Agents can also speak with appraisers, escrow officers, and title representatives about what they are seeing and hearing in regard to the latest up or down price swings.

Analyzing the Seller's Property

An agent would be wise to focus on at least three important details about the seller's property before starting their CMA report. These three main issues should include:

- 1) The property's neighborhood (or neighborhood analysis);
- 2) The property or site analysis (the home itself, the location, and the amenities); and
- 3) The improvements on the property that make it somewhat different from and perhaps more valuable than other nearby comps.

Neighborhood Analysis

Location might be the most important factor in any value analysis. For example, a 2,000 square-foot home built out in the middle of the desert in San Bernardino County might sell for \$250,000, while the same home would probably sell for \$1.5 million or more if located within one block of the ocean in Laguna Beach. Other neighborhood factors that can increase or decrease a property's value include physical obstacles, noise issues, and pollution (e.g., properties too close to highways or chemical plants), and whether the home is surrounded by newer individual custom homes and housing subdivisions or has rundown 40-year-old homes on all sides.

There are also two older economic theories for real estate values. They are the Principle of *Progression* and the Principle of *Regression*.

Principle of Progression: The value of smaller or less expensive properties will likely increase when surrounded by larger and newer properties. Sometimes, the best investment is to buy the oldest and smallest home in a nice community because the neighboring superior properties will probably increase the smaller home's value over time. This can be especially true if the new buyer fixes up and modernizes the older and smaller home.



Principle of Regression: This real estate valuation theory states that a property of much higher value than the surrounding inferior (or smaller or older) properties will likely be negatively affected when compared to the lower value properties nearby. One way to remember this theory is to imagine someone buying and tearing down an older home before breaking ground to build a McMansion-type home that is the newest and biggest one on the block or within a two-mile radius. The over-improvement of this property will still be hurt by the nearby older, smaller, and rundown homes because those are still the most likely to be used as future price comps when the owner of the fanciest home on the block is ready to sell.

The **neighborhood analysis** for the CMA report **may include some of these factors:**

- 1) Percentage of homeownership: Properties with too many tenants nearby in rented homes can negatively impact property values.
- 2) The number of vacant homes and lots nearby. The estimated value of land can be derived from a few methods such as a review of

the assessed value by the county assessor's office and a few different appraisal methods related to current and future value.

3) Conformity: Are the homes similar to one another in terms of style, age, size, and quality?

4) Is the zoning nearby more residential or commercial? Homes built too close to industrial warehouses or agricultural sites with lots of noise and pollution can hurt nearby home values.

5) Are the streets in good or bad condition?

6) Does the neighborhood have access to all of the main utilities that most buyers prefer these days such as water, electricity, gas, internet, and cable television?

7) How is the neighborhood's proximity and ease of access as it pertains to highways, airports, and other types of transportation centers?

8) The quality of schools is one of the most important factors for many buyers with children.

9) Age and safety of the neighborhood: Is the region on an upward swing, or a downward economic descent with lots of foreclosures, crime, and burned down properties.

Site Analysis

The agent will compare the amenities found in the home (i.e., number of bedrooms and baths, square footage of livable space, etc.) and lot sizes and configurations (width, frontage, depth, and topography of the lot) with other properties.

Property Improvements and Differences: The agent will then account for any positive or negative differences between the subject property and selected price comparables. A home with a pool usually adds a lot of property value while a home with a backyard without any grass or landscaping will probably decrease in value. Other positive additions include air conditioning, a fully remodeled and updated kitchen with built-in Sub Zero-type refrigerators and cherry wood cabinets.

Other important factors for properties selected as price comps are the most recent date of sale, the location of the comparable, the terms of the sale (e.g., cash for a quick closing at a slight price discount), the motivation of the seller who may have been facing an imminent and impending foreclosure action, and other positive or negative reasons that could have influenced the price significantly one way or another.

The finished CMA report needs to be fairly simple to understand for the seller. These days, many people don't want to spend an hour or two digging through a lengthy report to arrive at the potential value. In the era of smartphones, online search engines, social media, and much shorter attention spans for many Americans, it can be beneficial to provide a short CMA form that the seller can read and comprehend within a minute or two.

A professionally created CMA report that helps show the seller that the best list price is well below the price the seller had in mind can be the difference between a property never being shown by other agents or buyer prospects because it is priced too high, and a property selling rather quickly to the pleasant surprise of both the seller and the listing agent. Once again, many sellers are too emotionally attached to their homes to clearly make an informed decision about the most realistic current market value for their home that is filled with beloved and cherished memories that only they can see.

Listed below is a short-form CMA report that a seller can read in less than

one minute before hopefully agreeing to price the new listing somewhere near these same price comparables that the agent worked hard to gather:

Comparable A: 4 bedroom, 3 bath, dining room, 2-car garage, small backyard, 4 years old. Sold 3 months ago for \$375,000

Comparable B: 3 bedroom, 3 bath, dining room, 2-car garage, backyard with a small pool, 4 years old. Sold 5 months ago for \$355,000

Comparable C: 4 bedroom, 2 ½ bath, large living room, 3-car garage, backyard with a large pool and spa, 5 years old. Sold 6 months ago for \$410,000.

Comparable D: 3 bedroom, 2 ½ bath, extra game room, 2-car garage, unfinished backyard with minimal landscaping, 6 years old. Sold 8 months ago for \$335,000

Should there not be enough recent property sales near the subject property about to be listed, the agent may wish to consider providing some listings of properties that are currently for sale to show the seller the current market competition as well as potential new sales comparables if and when they sell. The more informed a seller is these days, the happier both the seller and agent will be after hopefully pricing the home at the most realistic price possible so that it sells within a relatively short period of time.

Chapter Three Summary

- The agent is really selling him or herself, first and foremost, in real estate transactions. The agent should be courteous, well-dressed, and a very good listener. Listen first to the customers, and then build the marketing presentation around their interests and needs.
- New agents should tap into their **sphere of influence** (friends, family, past co-workers, and schoolmates) when starting out in the field. Over time, the agent can tap into more “real world” and “digital world” connections.
- The most affordable marketing methods that a new agent can create in the real and online worlds include business cards, flyers, magnetic car signs, a blog on a website, and short videos. As of 2020, the top two social media sites by user numbers were *Facebook* and *YouTube*.
- To learn why a person is motivated to buy, sell, or lease, the agent should ask a lot of questions to find the reason that inspires them to meet with the agent. Motivated clients are more likely to close deals.
- Value is truly subjective for property owners and buyers and not set in stone. True market value is established by a mutual agreement between a willing and able buyer and a seller who is not under duress or unfair pressure to sell.
- **Value in use** is more of an “eye of the beholder” situation when a property owner thinks their beloved home is worth much more than market value partly due to their fond memories.

- The **value in exchange** (or **market value**) is the objective value for a property as seen in the eyes of an average person who has no favorable bias towards the home.
- A **CMA (Comparative Market Analysis)** report will likely include sales or listing comparables within the past six (6) months of the date of the completed CMA report.
- Appraisers are likely to use one, two, or three approaches to determining the value of land, homes, or commercial properties. The three value approaches are: 1) Cost approach; 2) Income approach; and 3) Sales comparable approach (most often used in the CMA report).
- **Principle of Progression:** The value of smaller and/or older properties will probably increase when surrounded by larger and newer properties.
- **Principle of Regression:** Inferior and smaller properties that surround a property that is overbuilt for the neighborhood may negatively affect the larger home's value (e.g., a large, modern home built in a neighborhood of older, small, two-bedroom, one bath houses).

Chapter Three Quiz

1. Which group is the least likely to be part of an agent's "sphere of influence" for marketing purposes?
 - A. Friends
 - B. Family
 - C. Schoolmates
 - D. Other agents

2. Which answer below is not a type of personal advertising for an agent?
 - A. Business cards
 - B. Magnetic car signs
 - C. Calendars with the agent's name on it
 - D. Property listing on MLS

3. Which party is likely to believe that a certain property type has the highest value potential under the **value in use** theory?
 - A. Buyer
 - B. Owner
 - C. Agent
 - D. Appraiser

4. What is another name for a **value in exchange**?
 - A. Value in use
 - B. Equilibrium price
 - C. Market value
 - D. Highest and best use

5. What is the purchase amount called for the amount actually paid for a property?
 - A. Market value
 - B. Market price
 - C. Subjective value
 - D. Objective price

6. Which items may be included in a CMA report?
- A. Sale price comparables
 - B. Listing price comparables
 - C. Property amenities
 - D. All of the above
7. What are the oldest sales comparables that an agent should use for a CMA report?
- A. 3 months
 - B. 6 months
 - C. 9 months
 - D. 12 months
8. A buyer who is given two almost exact properties to choose from is more likely to purchase the property that is priced lower under the economic theory of ____.
- A. Principle of substitution
 - B. Principle of comparison
 - C. Supply and demand
 - D. Replacement cost
9. The value of smaller and older properties will likely increase when surrounded by larger and newer properties under the economic theory of ____.
- A. Demand and supply
 - B. Principle of Regression
 - C. Principle of Progression
 - D. Market replacement

10. The real estate valuation theory states that a property of much higher value than the surrounding inferior (or smaller or older) properties will likely be negatively impacted is the _____.

- A. Principle of substitution
- B. Principle of regression
- C. Market price
- D. Market equilibrium

11. Where is usually the best source of recent sales for CMA reports?

- A. Public records
- B. Asking neighbors
- C. MLS
- D. Escrow companies

12. Depreciable basis is used to describe _____.

- A. Land
- B. Market price
- C. Building improvements
- D. Assessed value

Answer Key:

1. D	6. D	11. C
2. D	7. B	12. C
3. B	8. A	
4. C	9. C	
5. B	10. B	

CHAPTER 4

Prospecting and Business Development

Overview

Agents must creatively and effectively work as hard as possible to develop new connections and increase their sphere of influence at the start of their career as well as throughout it. At first, agents may spend much of their time working on marketing and prospecting strategies that are free or almost free to develop and implement. We will cover some of the best ways for agents to meet new prospects and potential clients using methods like tapping into an ongoing referral system, telephone, email, print media, online marketing strategies, and other plans of action to increase the size of the geographic farm.

Note that a person who advertises himself as an agent without holding an active license could be fined up to \$20,000 and be imprisoned for up to six months. It is therefore imperative that you obtain your license *before* you begin advertising!

Real World and Digital World Marketing



Most real estate agents today will use some combination of print media and online marketing methods to promote their property listings and services being offered to the public. Some agents may spend more on their print media advertising efforts such as in newspapers, magazines, flyers, and postcards that are mailed or handed out. Other agents may spend most of their advertising budget on online marketing strategies such as blogs, websites, and online ads. Online advertising on social media like Facebook and review sites like Yelp that are targeted to potentially interested buyers and sellers may be very effective as well as employing email marketing campaigns. When the internet first became popular in the mid-1990s on a larger scale, a high percentage of real estate agents believed that the internet might destroy the real estate industry or damage it significantly. It has actually been helpful!

In some weeks or months, the print media strategies may be more successful than the online marketing methods. Other times, the online strategies work much more effectively than print media campaigns. Some new agents have a very small marketing budget to work with in the first few months of work, so their budget options might include only some new business cards and some black and white postcards that can be handed out around town. Shortly after the agent closes his or her first deal or two and collects a much-needed commission check, the agent will have more funds to invest in various marketing strategies both online and in print media.

A 2015 study that was compiled by the National Association of Realtors (NAR) and entitled ***Statistics on REALTORS® and Technology*** found an ever-increasing reliance on technology and online marketing methods used by agents. The NAR's numbers were as follows:

- 27% of agents and 21% of brokers surveyed had spent between \$500 and \$2,000 in the previous 12 months.

- The top three digital devices that the agents who were surveyed had planned to purchase or replace over the next year were: iPad (16%); Smartphone (15%); and a digital camera (12%).
- *Windows 7* by Microsoft was the most frequently used operating system for 38% of the real estate licensees surveyed.
- The three most popular Smartphones were the iPhone (52%), Android OS (45%), and Blackberry (3%).
- 91% of all REALTORS® had used social media for marketing purposes to at least some extent.
- The three most popular sites for REALTORS® to place their listings were Realtor.com®, then Zillow and then Trulia.

Which online site is the most popular for agents to place their listings?

In 2018, NAR conducted a survey about technology issues in the real estate industry. They found that the three most valuable technology tools agents used in their business were local MLS websites (64%), lock box/smart key devices (39%), and social media platforms (28%). And, according to the survey, the technology tools that have given agents the highest number of quality leads in the previous 12 months were social media (47%), their MLS site (32%), their brokerage's site (29%) and listing aggregator sites (29%). (Aggregator websites do not produce their own content. Instead, they collect content from other websites around the Internet and “aggregate” it into one easy-to-find location. Listing aggregator sites are beneficial to both agents and their clients.)

Geographic Farm



A **geographic farm** is a specific target marketing area that is consistently worked by an agent. Agents will probably select regions near their main office or near their home when first starting out in the business. The areas that are closest to the agent's home or business location are usually regions that with which the agent is most familiar with respect to property values, business activities, planning and zoning guidelines, and other factors that can influence the latest market value trends.

Agents will likely start out with a relatively small neighborhood block or concentric circle area prior to later increasing the marketing size of their farm regions. It is the intent of agents to quickly build name and face recognition among those people who live and work within their targeted geographic farm. It can help the agent to first have some established contacts in that area before beginning his or her marketing campaign. Each person they know in the area can later introduce the agent to their neighbors, friends, and family nearby.

Agents who share common interests with the neighborhood first selected

to farm will often feel more comfortable when speaking with the residents. These common interests often include such factors as all of them living within the same master-planned subdivision and/or perhaps they went to the same schools together even as far back as elementary, middle, or high school. Other shared and relatable connections that may make farm prospects more open to listening to the new agent's real estate sales presentation include attending the same place of worship together, belonging to the same community groups, clubs, or sports teams such as the local softball, tennis, or bowling league, and shared mutual friends. Often their children go to school together and play together.

Some neighborhood blocks or entire subdivisions might already have one or two real estate agents who have farmed these communities as well as sold many homes there for the past several years. If so, these types of farmed communities may be a bit more challenging for new agents to target market. However, some residents in the community might have had some bad past experiences with the other experienced agents, so they may be more willing to listen to new and enthusiastic agents who are willing to work as hard as possible to gain their trust.

Some real estate marketing experts suggest that agents begin with a farm size of no more than 100 to 500 homes. This is partly due to the fact that the costs associated with the creation of new business cards, four-color postcards, and flyers could be much higher than the new agent's marketing budget. Additionally, the weekly walking and door knocking involved with more than 500 homes might be too much effort for agents not used to walking several miles at a time when canvassing such a large farm marketing region.

At a later date, after the agent has closed several real estate deals and received some profitable commission checks, the agent will likely increase the size of their farm for marketing purposes. The increased farm size that could include thousands or tens of thousands of properties and owners is called **mega-farming**. Many successful agents will create teams of affiliated real estate agents and salaried assistants to help them to

consistently send out marketing materials to their thousands of prospects or knock on their front doors on a monthly basis.

Agents should view the costs associated with a marketing campaign as more of an **investment** than an expense. Sometimes, an agent will spend \$500 to create thousands of four-color postcards that they will drop off in person at prospects' homes or in a community that will later lead to one closed home sale.

If the net commission earned is \$5,000, the agent has generated a 1,000% cash-on-cash return (or 10 times the marketing expense) over the period of just a few months. For deals that close escrow three months after the investor spent \$500 in advertising expenses, the annual returns are closer to 4,000% (3 months x 4 = 12 months) (1,000% x 4 = 4,000%). Even the Dow Jones stock index today that is at all-time record highs does not typically generate annual returns of 1,000% or higher.

Just like with an agriculture farm, a real estate marketing farm takes time to cultivate prior to producing valuable crops or financial returns. If a farmer does not pay enough attention to his crops and provide them with enough water and nutrients, his crops will wither, die, and the farm will probably go out of business. The same can be true for agents who do not spend enough time tending to their marketing farm for new business.

Regardless of which type of marketing strategy an agent selects to get started, the end result that should be sought by each agent is the ever-increasing size of the farm region and client contact list. Agents should strive to cultivate at least one new prospect or customer each month when starting out in the real estate field. Once the farm prospect list size grows much larger, then hopefully new prospects will be knocking on the door of that agent with new successful opportunities for all parties involved.

Non-Geographic Farms

A **non-geographic farm marketing strategy** is one that is based more on the similarities of the types of owners and/or property types rather than a shared neighborhood subdivision. For example, an agent who is a member of the local Elks, Moose, or Shriners Lodge may put together a target marketing campaign that emphasizes the “brotherhood” (or “sisterhood”) of their group and how the members should be loyal to one another by working with each other directly or referring their friends, family, and coworkers to each lodge member.

The members in social, community, sports, or church or synagogue clubs might own properties in many different regions around the agent’s city, county, or even state. The agent might create new opportunities for listings for nearby properties or for referral fees related to properties on the other side of the county or state by focusing on the shared mutual interests between the agents and prospects instead of at a specific neighborhood location.

Other types of non-geographic farm approaches can include the creation of a target marketing campaign that reaches out to all of the absentee or non-owner occupants of single-family homes and two to four unit properties within a specific zip code region. Some agents will take it one step further by focusing primarily on out-of-state absentee property owners. The agent might consider creating postcards with the latest property value details, market sales and rental comps that are sent out to each of their absentee owners who may live outside the same zip code, city, county, or state.



A door-to-door marketing campaign for a non-geographic farm will seldom be very effective because the properties and owners are scattered all over the place. Door-to-door marketing is a better approach for one neighborhood block or subdivision that an agent can walk within an hour or two.

Many absentee owners will probably appreciate learning about the latest numbers regarding the current directions of sales and rent comps that are similar to the properties that they own. Some of these absentee owners may not have any personal relationships developed with other nearby local real estate agents, so they might be more willing to speak with the agent who has kept them informed for the period of weeks, months, or years with a farm marketing campaign. The absentee owners who rent out their single-family home, duplex, triplex, or fourplex will likely be interested in learning about the latest sales and rental price trends nearby that can help or harm their own property's value.

The agent can find much of the latest sales and rental price data from their office's MLS system, title insurance companies, printed statistics

provided for free by various data sites, and from public records. A sample postcard that may be created and sent out to absentee owners of single-family homes or two-to-four unit properties in the same zip code, city, or county might include details like the examples below.

Latest Sales Price Trends for Homes in Mountain Falls

Sales

1) 5701 Shorebird Place - Selling price: \$675,000. The property is a 3 bedroom, 2 bath, 1,892 square foot home that was built in 2012. Closing date: June 6th, 2017.

2) 6248 Grand Junction - Selling price: \$590,000. The property is a 3 bedroom, 2 bath, 1,745 square foot home that was built in 2012. Closing date: May 15, 2017.

3) 13822 Mariposa Drive - Selling price - \$610,000. The property is a 3 bedroom, 2 bath, 1,650 square foot home that was built in 2015. Closing date: July 2, 2017.

Rents

1) 5278 Sagamore Drive - Listed Rent Price: \$2,400 per month. The property is a 3 bedroom, 2 ½ bath, 1,820 square foot home that was built in 2010. The property was leased just 16 days after the rental terms were posted online. The final terms of the signed lease agreement were not available to public records.

2) 2873 Warner Avenue - Listed Rent Price: \$2,650 per month. The property is a 4 bedroom, 2 bath, 1,900 square foot home that was built in 2008. The property was leased 24 days after the rental terms were posted in the MLS and in other places online. The final terms of the signed lease agreement were not made public.

3) 5910 Tiburon Street - Listed Rent Price: \$2,950 per month. The property is a 4 bedroom, 2 ½ bath, 2,050 square foot home that was built in 2006. The property was leased 9 days after the rental terms were posted online and in the MLS. The final terms of the signed lease agreement were not provided.

Vacancy Rates in Mountain Falls (3rd Quarter 2017)

Apartments: 4.5%

Condominiums and Townhomes: 4%

Single-Family Homes: 6.25%

Duplexes, Triplexes, and Fourplexes: 5%

The median price paid per square foot to lease a residential apartment is currently near the \$1 per square foot range for long-term leases longer than 12 months. The median price to rent an attached condominium or townhouse unit is approximately \$1.20 per square foot. And the median price to rent a detached single-family home is in the \$1.30 to \$1.50 price per square foot.

For a free price and rent survey for your property, please give me a call or send me an email.

Agent's name

Brokerage firm's name and mailing address

Phone number and email address

Broker's license number

For both geographic and non-geographic types of farm marketing strategies, the agent must be consistent with their approach to reaching out to new prospects. Some prospects might throw away the first few

postcards, letters, or flyers received without even taking a second or two to glance at them. As time moves forward and the prospect begins to recognize the agent's name, brokerage firm, and their marketing strategies, the prospects might start paying closer attention to the agent's marketing material.

One of the best approaches to marketing for prospects is to send them notices about recent home-sale closings that the agent was directly involved with for properties close to the prospect's property. Any properties that recently closed escrow as a result of the agent's assistance will likely become a potential solid price comparable for the absentee owner's property.

These types of small postcard mailings might consist of the following details:

- A photo of the property that was sold (exterior and/or interior).
- The listing price and/or the sales price for the property that recently closed escrow and is now on public records.
- A quote from the satisfied property owner or some other past client about how wonderful the agent's services and professionalism were in the recent sales transaction.
- The agent's name, contact information, and the agent's free offer to provide a CMA (Comparative Market Analysis) study to any prospect who contacts them within the next week or so.

Bird Dogs, Referrals, and the Endless Chain

The **endless chain**, or a referral request that can be visualized as an infinite loop, is a method of prospecting that involves the agent asking their new prospects or long-time client contacts, friends, family, or past

co-workers to recommend other new prospects to the agent. It is a strategy used to increase the agent's sphere of influence by expanding the marketing circle from the agent's friends, family, past co-workers and schoolmates, to others. Some agents might attempt to get a list of just three names and their contact details from each of their friends, family, prospects, and long-term clients.



For an agent with 100 contact names in his or her database to start the endless chain process, the circle, or sphere of influence can grow and expand at seemingly infinite and exponential rates. For example:

- 1) Step 1: 100 contacts.
- 2) Step 2: Ask each contact for three (3) new prospect names for people who might be interested in buying, selling, or leasing properties in the area. The number of contacts will then grow in size to 300.
- 3) Step 3: Ask each of these 300 contacts for a list of three (3) brand new contact names of parties with a potential interest in the agent's real estate services. The number of prospects will then grow in size to 900 prospects for the agent's contact list.

The absolute most important step involved in the endless-chain referral process is associated with the agent actually asking for the new prospect leads. Agents are not allowed to pay referral fees from any commissions they later receive after closing a transaction based on a referral from an unlicensed prospects or a past client, but they can send them a heartfelt thank-you card or refer new clients to the prospect's or former client's place of business.

Prominent Business Owners

Each town or city usually has some type of central influential private club, religious group, social activity center, or government-sponsored club or agency to which hundreds or thousands of community residents attend on a fairly consistent basis. An agent who has a positive reputation with certain types of well-respected business professionals and those from large organizations is one who may have a fairly high number of business referrals sent his or her way. As long as the agent keeps performing as needed and expected, the referrals can keep coming for many years.

Individuals who are highly respected and well-connected with hundreds or thousands of their own clients can be an exceptional starting point for agents to seek out new client referrals. These influential individuals in the community may include:

- Accountants
- Attorneys
- Doctors
- Wealth Advisors
- Financial Planners
- Bankers
- Mortgage Brokers
- Other Real Estate Agents who specialize in different sides of the business

- Ministers, Priests, or Rabbis
- Teachers and Professors
- Public officials, such as city council people and the mayor

Community Groups

Many prominent members of the local community are likely to belong to one or more community groups. If the agent is not already a member or affiliate of a specific community group, the agent could be introduced to the members of the organization by one of their influential clients, prospects, or referral sources such as a distinguished town doctor or minister at his or her church.

The community service groups that agents may wish to consider joining partly to expand their contact list as well as to create long-lasting and high- quality friendships may include:

- The Chamber of Commerce
- Educational groups like the PTA (Parent-Teacher Association)
- High school and college alumni groups
- Churches, synagogues, and other spiritual centers
- Boys' and Girls' Clubs
- Boy Scouts and Girl Scouts
- YMCA and YWCA organizations
- Sports teams or clubs (golf, tennis, biking, boating, skiing)
- Senior clubs
- Political groups

Contact Management

Do-Not-Call Registry

The **Bureau of Labor Statistics (BLS)** estimates that there are at least 189,000 people employed in the U.S. as telemarketers. Each day of work, they call thousands of people. The “robo-dialers,” or computers or fancier versions of A.I. (Artificial Intelligence) systems, will more likely call even more people on a daily basis than human telemarketers. As a result, our home and cell phones tend to ring on and off all day long, many days with calls from both live and robotic telemarketing systems.



As of 2004, the **National Do Not Call Registry** system was created to assist people with the ongoing daily harassment of telemarketers trying to sell them a product or service that they don't need or want. To sign up for the national do not call list, a person can go to their website (<https://www.donotcall.gov/>) to sign up their name, phone number, and email address and they will receive confirmation that their number is being added to the national list. Once verified by the site via an email confirmation, the process to sign up for the do not call list should be complete. Or, a person may call the toll-free number at 1-888-382-1222 to add one or more phone numbers to the national Do Not Call list.

There is absolutely no cost for consumers to add their names to the

national Do Not Call registry. The registration of each phone number on the list will not expire in the future. The Federal Trade Commission (FTC) will not unilaterally drop a person's phone number from the Do Not Call list after a period of five years has passed as some people believe. Because it is free and so easy to add a person's phone number (or multiple phone numbers all at once) to the Do Not Call list, real estate agents should be especially cautious before undertaking a "cold call" marketing campaign to homeowners or other prospects.

As of September 30, 2020, there were 241 million active registrations on the national Do Not Call list. Over the past several years, the fine risks per telephone call occurrence have varied between \$11,000 to \$40,000 per call. Additionally, consumers may have the option to file individual lawsuits or civil complaints for between \$500 and \$1,500 for each unauthorized and unwelcome call received. If a telemarketer makes 10 calls to a homeowner over the period of one week, they may be faced with a lawsuit up to as high as \$15,000 (\$1,500 x 10 calls) plus significant fines issued by the Federal Trade Commission (FTC) or the Federal Communications Commission (FCC).

For example, in 2015, a woman filed a civil complaint at a local courthouse near Irving, Texas against a cable company due to the 153 robocalls she received within a relatively short period of time. The court awarded the injured party \$229,500 in damages as a result of the cable company's continued violation of calling and bothering her at home so many times. Other national telemarketing companies have been fined as much as several million dollars for calling consumers on the national Do Not Call list.

Telemarketers must stop calling most phone numbers entered on the Do Not Call list that have been posted on the list for at least 31 days. Should any telemarketer or real estate agent fail to comply with the consumer's request to cease the telemarketing calls, the consumer can visit donotcall.gov or call the toll-free number provided above to file a formal complaint.

There are still a few organizations that are exempt from the national Do Not Call registry that may still call us. These groups include political organizations, survey takers, and most charities. Sadly for real estate agents, some homeowners can get very frustrated with too many calls from multiple real estate agents who are offering their services if and when the homeowner is ready to sell. Agents who decide to start a cold call marketing campaign may wish to consider purchasing consumer phone lists that are not included on the national Do Not Call list in order to reduce any risks associated with this practice.

Door-To-Door Canvassing: This is when one or more agents will literally knock on doors to meet and greet homeowners. The agent may hand the homeowner a copy of a flyer or a four-color postcard that includes details about the latest neighborhood price trends. The agent will then ask the homeowner to call him or her if and when he or she is ready to sell or if they have any friends or family interested in the services of a real estate agent for buying, selling, or leasing.

FSBOs



One of the best ways to find new clients is to call and visit a FSBO (For Sale By Owner) prospect trying to sell a home on their own. Some FSBO property owners have had bad experiences with real estate agents in the past or want to save \$10,000 or more in commissions, so they opt to

attempt to sell the property themselves. Numerous sales studies have shown that homes listed with real estate agents are much more likely to net the seller a higher profit margin, even after a 3% to 6% commission is paid to the agents involved with the transaction, compared with FSBO owners who try to sell properties without any professional assistance.

Part of the reason for higher profits to sellers who hire agents to handle the listing is that agents will usually expose the property to a much larger target audience after listing the property on the local MLS as well as marketing it online and in print media. Most FSBO owners are not going to be very familiar with sales strategies and the required disclosure forms that must be offered to buyers in the state of California. If the FSBO owner is not even offering a 3% commission to buyers' agents to bring their clients to see their home, the odds are much lower that any agent will want to stop by and see the property in person either alone or with their clients.

After months and months of very few visitors to see a FSBO property, the homeowner may give up and take their FSBO sign off their front lawn. It is at this point that the agent should reach out to the owner with their own new marketing plan that can help the owner sell the property at the highest price possible and in the shortest amount of time. This same FSBO seller may later turn into a new buyer or tenant prospect for the agent, so there could be two quick transactions for the same agent.

The last home market study about the comparison between FSBO properties and properties listed with a real estate licensee conducted by the National Association of Realtors was published in 2015. They found that:

- 8% of all home sales that year were completed as a FSBO deal.
- The typical or average FSBO home sold for \$185,000 while the agent-assisted home sale was \$240,000.

The marketing methods used for FSBO deals on a percentage basis were:

- Yard sign: 33%
- Friends, relatives, or neighbors: 21%
- Online classified ads: 10%
- Open house: 21%
- For-sale-by-owner websites: 7%
- Social networking sites (e.g., Facebook, Instagram, etc.): 9%
- Multiple Listing Service (MLS): 13%
- Print media advertising: 3%
- Direct mail (flyers, postcards, letters): 2%
- Video: 1%
- No marketing strategy used at all: 41%

The same NAR study found that the most difficult tasks for FSBO sellers who tried to sell their own properties were:

- Pricing the home correctly: 18%
- Fixing up and preparing the home for sale: 13%
- Filling out the paperwork correctly (disclosures, contracts): 12%
- Having enough free time to try to sell the property: 3%
- Selling as quickly as originally planned: 3%

Legal Notices

Notices of legal action can be an exceptional source of leads for new clients in search of assistance with their latest life's struggles. These legal notices can be found in small local classified ad papers, legal newspapers like the *Daily Journal* in Los Angeles, or in some of the larger print and online publications in the state such as the *San Diego Union Tribune*, *Los Angeles Times*, or the *San Francisco Chronicle*. Title insurance companies and various data market research and advisory companies like *DataQuick*, *Redfin*, *Zillow*, and *PropertyRadar* can provide some up-to-date and real-time analytics about the latest market prices, foreclosure status,

and other details that can help both agents and struggling homeowners.

Often, an agent can help alleviate the client's family struggles by acting not only as a real estate agent, but also as part therapist, part spiritual advisor, and part financial advisor all rolled into one. For many people, a catastrophic event related to a recent loved one's passing, a divorce, or a serious health problem may lead to financial ruin and bankruptcy or to a foreclosure action that might force the property owners to move away. These are just some of the most common reasons for owners to need a quick sale of their home.



In America, the #1 cause of bankruptcy is related to skyrocketing medical bills. The #2 reason is usually listed as divorce. Most Americans today have the bulk of their family's net worth tied up in the equity of their primary or main residence. In unexpected divorce or near

financial insolvency situations in which the owner almost runs out of cash and credit card access options, many property owners will become quite motivated to list their homes for a quick sale as soon as possible.

A family may be hit with the horrific combination of a severe health crisis or illness with one of the family members, the loss of a job, a divorce, a foreclosure filing, and the potential threat of a near-term bankruptcy advised by the family's attorney to prevent the lender from taking the family's home prior to evicting them. In painfully stressful family situations like these, an agent who has contacts with experienced accounting and legal professionals and a definitive sales/marketing strategy that can quickly solve their at least part of their family's financial dilemma is one who will be welcomed with open arms.

Divorce: Some agents spend much of their career focused on divorce filing notices as a strategy to find new listings. With most marriages, the equity in the primary home is usually the main asset that the husband and wife battle over in family court, mediation, or through private arbitration that is determined by a retired judge selected by both parties in the action.

California was the first state in the U.S. to offer a "no-fault" divorce beginning in 1970. The no-fault divorce option made it much easier to file for divorce primarily since neither party had to prove any wrongdoing committed by the other spouse during the marriage. In years prior to the enactment of no-fault divorce, one spouse might have to hire a private investigator to search for any change, such as their spouse having an affair with someone outside of the marriage. After 1970, no valid grounds need to be presented to the family court to start the divorce proceedings.

Let's take a look below at some of the most shocking divorce and broken family numbers that impact the housing markets each year.

- The national divorce rate is in the 50% to 53% range.

- California's divorce rates are higher at around 60%.
- 41% of first marriages end in divorce.
- 67% of second marriages end in divorce.
- 74% of third marriages end in divorce.
- On average, marriages that end up in divorce last about 8 years.
- There is one divorce every 36 seconds across the nation; 2,400 divorces each day; 16,800 divorces per week; and 800,000 to 900,000 divorces every single year.
- Divorce rates for Americans over the age of 50 have doubled between 1990 and 2015, per the Pew Research Center. One in four marriages of people over 50 ends in divorce.
- As of 2018, America had the highest percentage of one-person households in the world at 28%.

(Source: CDC/NCHS National Vital Statistics System)

One of the most stressful things to do for many families is to sell their beloved home where they spent many years or decades raising babies to young adults. If the sale involves an impending divorce, the stress levels will likely magnify and compound. For any real estate agents who seek to concentrate on pursuing properties that involve soon-to-be divorced homeowners, they should be as compassionate and empathetic as possible while treating both the husband and wife equally and fairly.

In 2012, the *Orange County Register* reported that there were an average of 33 divorce filings every day just in Orange County alone (or close to 1,000 per month). Some of the most expensive real estate in the state, nation, and world are located in Orange County. As a result, there are tremendous opportunities for agents who create marketing campaigns that target divorcing couples. Because the household may split in two, there can be options to assist both divorcing spouses with a new rental or purchase deal shortly after the initial home sale closes escrow.

Foreclosure: Between 2006 and 2016, California had the highest total number of foreclosure filings -- Notices of Default, Notices of Trustee's Sale, or bank repossession situations if no bidders made an offer to purchase at the foreclosure auction -- of any state in the nation. This is partly because California has the largest population base, nearly 40 million residents, and the highest number of housing units. Across the nation in 2016, there were 933,045 properties in some stage of the foreclosure process. Out of this national foreclosure number, the Golden State alone had a reported 78,646 delinquent, foreclosure, or bank repossessions.

When comparing the total number of housing units to foreclosure activity, California was ranked 20th out of all states in September 2017, according to a study completed by ATTOM Data Solutions (a firm that tracks national foreclosure trends).



Foreclosure Rates by State

Rank	State	Total Housing Units	Ratio (1 in every.....)
1	Delaware	414,416	744
2	New Jersey	3,577,942	788
3	Maryland	2,410,256	1,117
4	Connecticut	1,491,786	1,286
5	Illinois	5,303,675	1,351
6	Ohio	5,140,902	1,375
7	So. Carolina	2,174,319	1,409
8	New Mexico	909,565	1,508
9	Florida	9,094,999	1,559
10	New York	8,171,725	1,672
11	No. Carolina	4,417,210	1,732
12	Indiana	2,820,253	1,769
13	Mass.	2,827,820	1,791
14	Rhode Island	462,900	1,808
15	Oklahoma	1,689,427	1,844
16	Pennsylvania	5,585,611	1,895
17	Alabama	2,199,329	1,955
18	Maine	726,227	2,099
19	Louisiana	1,999,855	2,312
20	California	13,845,790	2,370

According to the Irvine, California-based RealtyTrac firm (a real estate information company and online marketplace for foreclosed and delinquent properties), the five counties in the state that have the most foreclosure filings as of October 2017 are as follows:

1. Kern: 1 in every 843 properties
2. Sutter: 1 in every 942
3. San Bernardino: 1 in every 1,101
4. Kings: 1 in every 1,103
5. Riverside: 1 in every 1,179

While foreclosure filings have come down in recent years, the pandemic saw the numbers tick up again. The top 10 counties in the US with the highest foreclosure rates as of November 2020 included two in California: Riverside County and Los Angeles County.

Property owners will usually receive a series of warning letters from their lender over at least a few to several months before the lender files the Notice of Default to begin the foreclosure process, which averages close to four months (or 120 days) without any postponements by the lender or bankruptcy filings by the consumer. The foreclosure filings are public record.

Some real estate agents specialize in contacting homeowners in one of the foreclosure stages as a way to pick up a quick listing for a conventional home sale or discounted Short Sale³ strategy. If an agent works on enough foreclosure deals in a specific zip code or city, lenders might start contacting them to list the bank's REOs (Real Estate Owned -- or properties taken back after the final foreclosure auction) when no other bidders or investors showed up to purchase the property.

³ A **short sale** is a **sale** of real estate in which the net proceeds from selling the property will fall **short** of the debts secured by liens against the property. In this case, if all lien holders agree to accept less than the amount owed on the debt, a **sale** of the property may be accomplished.

Bankruptcy: A bankruptcy filing can help consumers either completely wipe out their debt or create more financially sound monthly or annual payment plans that are more realistic for their current financial situations. It is a federal court action that is filed by the debtor or his or her bankruptcy attorney. For some business owners and property owners, a bankruptcy filing might be used to save the business from shutting down or as a strategy to prevent a foreclosing lender from taking the home away from the indebted borrower.



The two main types of bankruptcy filings for individuals are the **Chapter 7** and **Chapter 13** legal proceedings. The Chapter 7 bankruptcy filing action is generally more of a complete liquidation request in which the debtor is asking the bankruptcy court to wipe out most types of their personal or business debt.

Some forms of debt may not be completely wiped out with a Chapter 7

bankruptcy filing such as unpaid student loans, child support debt, recent tax obligations, and some civil judgments that were based upon allegations such as fraud. Often, the unsecured debt related to unpaid credit card balances are completely wiped out or zeroed out once the bankruptcy filing has been completed. The debt is said to be **discharged**. A consumer's home mortgage will not usually be wiped out or removed from the subject property. However, the consumer might be able to delay impending foreclosure actions, decrease some unpaid mortgage fees, or persuade the mortgage lender to modify their loan payments so that the borrower can continue to stay in the property.

A **Chapter 13** bankruptcy plan (or "reorganization plan") is used more by wage earners with a fairly consistent and reliable source of monthly and annual income. The bankruptcy court will likely offer debtors the option to pay off their debt with a new reduced monthly payment plan over the next three to five years. The new monthly amounts may be based on factors such as the debtor's current monthly income, the total combined amount of unpaid, outstanding debt, and how much the unsecured creditors would have received had the debtor been allowed to file Chapter 7 bankruptcy (zero is the most common answer).

The average start to finish times for a Chapter 7 bankruptcy filing is usually somewhere within the four to five-month range if no listed debtors try to dispute the Chapter 7 request. For a Chapter 13 workout plan, foreclosure actions might be postponed a year or more during the terms of the new payment workout plans.

It can be quite beneficial to agents to learn and understand the basic requirements, rules, and regulations when assisting clients who may currently be in some stage of the foreclosure process. Some mortgage borrowers wait up until the day before the scheduled foreclosure sale before they file for bankruptcy protection in the federal courts.

Once bankruptcy has been filed, it will stop, or "stay," any scheduled foreclosure auctions up until the bankruptcy filing has been dismissed or

discharged. During this time, an agent may be able to list the home for sale at a reasonable price prior to paying off the homeowner's debts. In many cases, the bankruptcy court must approve the impending sale at a price that the court deems "fair" so that the debtor's creditors have enough funds at the closing of the sales transaction. Other times, the borrower (or debtor) will have sufficient funds to pay off all their debts before they fully dismiss or terminate the bankruptcy filing.

Marriage and Birth Notices: Not all legal notices revolve around a negative event like foreclosure, bankruptcy, or death. For example, opportunities abound for agents to find new clients for purchase or lease transactions after searching the latest marriage and birth records in their local community. The newly-married couple may be in need of a larger residence for their new family that might also eventually include a new baby.



According to the CDC's *National Center for Health Statistics*, there were 6

new marriages for every 1,000 people in 2018. Back in 1990, the number of marriages was much higher at 7.9 per 1,000 people. Both marriage and fertility rates have declined in recent years as we now see fewer married couples and fewer babies being born.

Nationally, the birth rate for the entire country had reached a record low back in 2008 when the numbers hit 12.4 births per 1,000 people. But by 2020, the national birth rate has slipped down even lower to 11.6 babies per 1,000 people.

According to the California Department of Finance, the annual birth rate for California residents had dropped to *its* lowest level in 2016 when there were 12.42 births per 1,000 Californians. This birthrate was even lower than one of the worst financial years during the Great Depression in 1933, when it was 12.6 per 1,000 residents. But California's birth rate has fallen even further to about 11.3 per 1,000 people in 2020.

Some of the main factors influencing declining birth rates in the state and the rest of the nation include:

- Fewer marriages
- Fewer teenage pregnancies
- Higher birth control usage
- Record high student loan, mortgage, credit card, and automobile loan debt nationwide
- Younger people taking longer to graduate from college if they attend at all
- The unaffordability of many places to live in the state for people of all age ranges
- An increasing number of women choosing to have a child for the first time much later in life

This is especially true for younger families such as Millennials (the largest generational group overall by size as well as the number one group purchasing and leasing real properties across the nation). Between 2007 and 2012, the birth rates for women in their 20s fell by more than 15%, according to a study conducted by the Urban Institute. The reduced number of new household formations in California does play a role in the latest buying and selling trends associated with single-family homes, especially.



Chapter Four Summary

- Agents and brokerage firms will most likely spend the bulk of their advertising budget for online media. 91% of all REALTORS® have used social media for marketing purposes to at least some extent.
- The three most popular online sites for real estate agents to place their listings are realtor.com®, Zillow and Trulia.

- A **geographic farm** is a targeted marketing area that an agent will focus on when seeking new clients such as one specific neighborhood or subdivision. The agent may call or visit the prospects in person or mail them flyers or postcards.
- A **non-geographic farm** marketing strategy is one that is based more on the similarities of the types of owners and their interests or the types of property they own rather than a specific area or neighborhood. The shared interests may include social activities, sports teams, or religious groups. Or the agent may send out letters to owners of the same property types such as non-owner-occupied duplex, triplex, and fourplex properties.
- The **endless chain** is a method of a referral request which involves the agent asking their prospects, clients, friends, family, or past co-workers to recommend other new prospects to the agent.
- The **Bureau of Labor Statistics (BLS)** estimates that there are at least 189,000 people employed in the U.S. as telemarketers. As of 2004, the **National Do Not Call Registry** system was created to assist people with the ongoing daily harassment of telemarketers partly due to the frustration of so many daily calls.
- As of September 30, 2020, there were 241 million active registrations on the national Do Not Call list. The fine risks per telephone call occurrence may vary between \$11,000 to \$40,000 per call. Just one cold call made by an agent can financially devastate him or her if the unhappy consumer reports the agent to the Federal Trade Commission or to the Federal Communications Commission.
- The average **FSBO (For Sale By Owner)** home sold for \$185,000 while the average agent-assisted home sale was \$240,000. Eight percent of all home sales nationally in 2015 were FSBO. Many FSBO owners get frustrated by the home-selling process, give up,

and eventually hire an agent. There are incredible business opportunities for agents who focus on FSBO listings.

- Medical bills and divorce are the two main causes of foreclosure and bankruptcy. Agents should learn about the many different ways that they can assist troubled homeowners while creating tremendous commission opportunities at the same time.

Chapter Four Quiz

1. Which online site is the most popular for agents to place their listings?
 - A. Zillow
 - B. Trulia
 - C. Realtor.com®
 - D. Redfin
2. An agent who targets one neighborhood for marketing prices is engaged in a type of _____.
 - A. Non-geographic farming
 - B. Geographic farming
 - C. Mega-farming
 - D. All of the above
3. An agent who sends out four-color postcards to all non-owner occupied duplex owners in one county is conducting business by way of _____.
 - A. a Geographic farm
 - B. a Non-geographic farm
 - C. a Mega-farm
 - D. Blind advertising

4. A method of prospecting that involves the agent asking their new prospects or long-time client contacts is a(n) ____.
- A. Endless chain
 - B. Target market
 - C. Open market
 - D. Closed-end loop
5. How many people are employed in the nation as telemarketers, per the Bureau of Labor Statistics?
- A. 50,000
 - B. 100,000
 - C. 175,000
 - D. 189,000
6. How many individual active registrations were on the national Do Not Call list as of September 30, 2020?
- A. 241 million
 - B. 143 million
 - C. 52 million
 - D. 21 million
7. What is the maximum fine that a real estate agent can be forced to pay for just one cold call to a person who is listed on the national Do Not Call list?
- A. \$500
 - B. \$1,000
 - C. \$1,500
 - D. \$40,000

8. How many days after a person voluntarily places their name on the national Do Not Call list must a telemarketer stop calling them?

- A. 1 day
- B. 10 days
- C. 31 days
- D. 90 days

9. According to the National Association of Realtors, what percentage of sales completed nationally in 2015 were FSBO sales?

- A. 2%
- B. 5%
- C. 8%
- D. 12%

10. What is the number one cause of personal bankruptcy filings in America?

- A. Foreclosure
- B. Medical bills
- C. Credit cards
- D. Job loss

Answer Key:

1. C	6. A
2. B	7. D
3. B	8. C
4. A	9. C
5. D	10. B

CHAPTER 5

ADVERTISING

Overview

Real estate agents spend almost as much time advertising and promoting their products and services as they do showing properties and meeting with clients in person. The number one product that agents are usually promoting are the agents themselves. Solid advertising strategies are meant to inspire action by readers or television viewers such as contacting the advertiser directly as well as buying their products or services within the very near future. We will address the many different ways that agents can make advertising an important part of their business promotion that will make their phones ring and emails and texts ping on a daily basis.



Advertising Numbers

Agents must continue to have the mindset that each dollar spent on advertising is an investment as opposed to an expense. This belief will allow agents to strive to create the most effective types of advertising and marketing campaigns each week because they will later find out that the cash-on-cash returns from a successful advertising strategy can generate sizable annual returns. Some of the most valuable companies in the U.S. and the world spend millions or hundreds of millions on advertising each year. While agents do not have marketing budgets as large as a Fortune 500 company or a business listed on the Dow Jones index, they can start small with budgets as low as \$50.

Let's review a list below of the estimated aggregate or combined revenue spent on the advertising and public relations sector over the span of a 10-year time period (2008 - 2018) to better understand why advertising is key to the ongoing success of individual companies and the overall U.S. economy:

<u>Year</u>	<u>Amount (\$) Spent in Billions</u>
2008	86.83
2009	77.43
2010	81.20
2011	82.12
2012	87.34
2013	91.27
2014	95.69
2015	99.47
2016	105.84
2017	109.42
2018	118.03

* Source: *Statista*

A high percentage of advertising is designed to target people's subliminal beliefs where upwards of 97% of all perceptions originate. Many advertisers and television programmers (it is called television "program" for a reason) will try to promote their negative stories, first and foremost, as a way to make viewers more fearful, reactive, and easier to control, manipulate, or influence. Some past studies have shown that the ratio of "bad news" to "good news" stories featured on local and national news channels was at least 7 to 1. In other words, for every positive news story, there were seven negative news stories that kept the viewers glued to their television sets.



Advertisers on TV, in the print media, or online will also use influential marketing strategies as a way to generate strong reactions in their viewers' minds and hearts. Consciously, the viewer may feel positive

about the advertisement featured on their TV, such as for an ad related to the sale of a pharmaceutical product, for example, that shows a smiling woman swimming in a lake. Subconsciously, however, the ad might inspire fear for the viewer, and an overwhelming need to buy this product to reduce their fear.

It has been said over the years that there are only two core emotions in people: love and fear. All other feelings are just aspects or other sides of those two. An advertiser with a multi-million dollar marketing budget is more likely to base its advertising strategies on fear rather than love. While the sale of any product or service seems like it should be based more on love, most viewers will respond to an advertisement if they think that the product or service may reduce their negative, fearful reactions.

The figurative and literal *Mad Men* featured in a television series of the same name as well as some of the most powerful and influential advertising executives in America are on Madison Avenue in New York City. The “mad” in the *Mad Men* term that was coined in the late 1950s was used to describe the street where they had many of their top advertising headquarters as well as the marketing methods that were meant to make people more fearful and easier to control.

To simplify advertising strategies used by small businesses and global conglomerates, the main product being sold on television, online, or in newspapers is the creation of internal feelings in their viewers. If the feelings are strong enough, the viewer will probably take action to reduce the negative internal feelings and increase their positive emotions as well, possibly by buying the product being advertised.

Few products sold today can generate more positive or negative reactions than the sale of a person’s home. For many people, the purchase of their primary home is the largest investment that they will ever make in their entire life. A home purchase that turns out to be the best investment ever made by a young family can increase the size of their financial nest egg for many years or decades. Conversely, the purchase of an overpriced

property in a declining neighborhood or a poorly-timed home sale just before the market is ready to increase 10% per year for the next decade can cause tremendous heartache and financial pain for families.

An inspired and enthusiastic agent who is there to help his or her clients reduce their negative fears and increase their hope and faith is one who is more likely to have a long and successful career. Clients will later remember how their agent made them feel good about the transaction instead of fearful and sad about it. Most people want to be around others who are cheerful and positive instead of depressed and negative. With this in mind, agents should consider building advertising campaigns that maximize positive reactions in people so that they keep coming back again and again.

Institutional advertising: This type of advertising is implemented with the intent to create a favorable image of the real estate brokerage firm, the main employing broker, and the salespersons who work under the broker's license. One of the primary reasons for this type of advertising is to improve name brand recognition for the entire brokerage firm as well as to link the company's name with confidence, trust, and goodwill in the eyes of the beholder (or consumer). Franchised real estate offices will often run television and print media ads that try to promote a favorable impression in the viewer's mind of the firm.

Specific advertising: This kind of advertising may also be referred to as **operational advertising**. A prime example would be an agent's property listing that includes details like a photograph of the property, the listing price, the amenities found in the home (number of bedrooms and bathrooms, square footage), and the broker's contact information. The main intent of this ad is to inspire people to call about buying this particular home or finding other similar properties that the listing broker can later show them (called a **"switch property"**). An agent might choose to advertise other similar nearby properties as a way to attract new-buyer prospects to his client's property.

Who is the Target Audience?

Advertisers need to understand the basic characteristics of their targeted consumers before they develop an effective marketing campaign. One of the world's best advertisements about a product still can be fairly worthless if promoted to the wrong audience. For example, an ice company that pays \$5 million to hire a famous actor to sell their bags of ice on a series of television commercials that only run during the winter months in Alaska will probably have very poor ice sales. Why? Their target audience is already surrounded by free snow and ice! This type of fancy ice bag commercial should instead be featured on commercials in warmer climates and/or during the hottest summer months.



An advertising campaign is only as good as the target audience selected. Real estate agents should understand that **Millennials** (people born between the early 1980's and the early 2000's) now represent the largest

generational group of Americans today. As of 2015, there were an estimated 75.3 million members of the Millennial generation who were somewhere within the age range between 18 and the mid-30s. Several Millennial members reached their young adult age of 18 by the turn of the century (or the “New Millennium”) by the year 2000.

Let’s review the other three main generational groups here in the U.S. who real estate agents may work with at some point in their career include:

The Greatest Generation: The oldest Americans today tend to have a much higher net worth than younger generations. A member of the *Greatest Generation* is someone born prior to 1946. This generation’s group name was first coined by former NBC anchorman Tom Brokaw from his book of the same name about so many of the war heroes who bravely fought in World War II and who also survived the 10 years of economic depression (or *The Great Depression*) between 1929 and 1939.

Many of these same people were able to ride the inflation wave and experience the mostly positive economic boom over the past sixty years or so since the end of the depression, especially as it related to the ownership of real estate and stocks. By 2020, the age range of this older generation was from 75 years of age all the way up to 103.

Baby Boomers: These peak birth-rate years that began shortly after the end of World War II were from 1946 to 1964. The evolution of suburbia with the single-family home, the green front lawn, and the white picket fence that was seen on television shows and films back in the 1950’s, 1960’s, and 1970’s is what so many young Baby Boomers pursued in order to find the proverbial “American Dream.” Most Baby Boomers in 2020 are aged somewhere between 55 and 75 years of age.

Over the past several decades, members of the Baby Boom generational group have purchased the highest percentage of properties nationwide. It is only in recent years after 2015 that

Millennials have surpassed them as the largest group of buyers and tenants.



Generation X: This generational group was born between the years of 1965 and 1984. This group may also be referred to as *The Baby Bust* group, because the birth rate numbers began to fall. The *Baby Boomer* numbers averaged more than three children per household for so many years. In 2020, members of *Generation X* (or “Gen-Xers”) were aged between 40 and 55. This generational group also currently has the largest unpaid student loan debt in the nation. These same outstanding student loan balances can be the difference between a Gen-Xer becoming a home buyer or remaining a tenant if the debt is too staggeringly high for them to maintain.

Since 2015, Millennials have also represented the largest generational group of homebuyers and tenants in the nation. According to a survey completed by the *Pew Research Center*, Millennials are projected to peak

by 2036 with close to 81 million members. In the same year, the oldest Millennial member will be around 56 years of age. As a result, new agents may want to focus on tailoring marketing campaigns to the Millennial generation for at least the next few decades if they hope to be successful.

A study provided by Inman and the National Association of REALTORS® entitled *Home Buyer and Seller Generational Trends Report 2020* offered some truly eye-opening statistics and data trends as it pertains to how Millennials rely upon both agents and digital devices when searching properties to buy, sell, or lease. Some of the details from the report include the following:

- Over 90% of Millennials will use a real estate agent to complete their transaction.
- 74% of Millennials polled would hire their real estate agent again, or refer the agent to their friends, family, or co-workers.
- 70% of Millennial home buyers plan on working with their agent again, or would happily refer their agent to others.
- 45% to 51% of Millennials were originally referred to their real estate agent through a friend or family member.
- 93% of Millennials used online websites for home searches.
- 51% of Millennials later closed escrow on the home that they first found online.
- 13-25% of all home buyers nationally were Millennials; Generation X members represented 23-25% of all buyers; and Baby Boomers made up 15-18% of all national buyers. The Greatest Generation made up only 6% of all home buyers nationally.

Of the four main generational groups today that also include *The Greatest Generation*, *Baby Boomers*, and *Generation X*, the Millennial generation is the one that is the most tech savvy. Most of these younger Americans were using computers, Smartphones, and digital tablets as far back as when they learned to walk, talk, attend kindergarten, or middle school/junior high. As such, the main target audience for real estate

agents today grew up clicking on a button for answers and solutions within a second or two. Now, agents must do what they can to capture their viewers' attention in the much shorter window of opportunity time as compared with past years. Millennials' expectations may be higher in terms of finding something quickly.

The Debt Anchor

As noted earlier, the equity (or the difference between the current market value and the existing mortgage balance) in a person's primary residence usually represents the highest percentage of the person or family's overall net worth. If polled or surveyed, most Americans would say that one of their main dreams in life would be to buy a home instead of pay rent because they feel they are throwing money away and making their landlord rich. Yet the main thing holding people back today from pursuing their dream of homeownership is debt.



Few things in life make people more fearful than overwhelming levels of debt. When people are too fearful, they tend to freeze up like a deer in headlights. Agents will often function as financial advisors and therapists

to calmly reassure the client that they can afford to buy this property if the client really wants it and the numbers bear that out.

There is an old saying that goes something like this as it relates to fear and avoidance: “What we avoid in life controls us.” To alleviate the client’s fears about whether they can afford to pay for a new home mortgage in addition to their monthly credit card bills, student loans, car loans, and still have money left over to buy groceries, a savvy agent might offer to sit down with their clients and build a budget plan with them. An even more empowering approach might be for the agent to refer their client to a financial advisor or a certified financial planner who can assist the client with their dreams of buying a home and one day paying off most or all of their consumer debts that hold them back like a figurative anchor.

Certain types of debt cannot be wiped out by a bankruptcy filing action as of 2019. These debts usually (but not always) include past student loan debts from colleges or universities. By the end of 2019, the total amount of unpaid student loan debt balances exceeded \$1.6 trillion dollars. This is now the second highest category of unpaid consumer debt in America, behind only mortgage loans (\$9.86 trillion plus for all residential and commercial loans combined). Both credit card loans and automobile loans are each over \$1 trillion in combined debt nationwide. These make up the top four categories of consumer debt.

A study completed by the *Wall Street Journal* and published in 2017 found that the student loan debt numbers were possibly much worse than was being reported by government-funded studies as noted below.

- The interest amounts due on the unpaid student loan debt grows at a rate of at least \$100 billion per year. If and when interest rates begin to rise again to more normal rates that are much higher than the near-record low rates today, the interest payment amounts will grow much higher as well.

The U.S. Department of Education last reported in 2017 that the repayment rates for unpaid student loan balances were about 19.8% without any default within 12 years after graduation, and that there was a 25% default rate within 20 years after the loan payments were due.

- The *Wall Street Journal* did its own detailed research of 1,000 colleges and trade schools (or about 25% of the total number of schools nationwide) and discovered to their unpleasant surprise that **at least 50% of all students had defaulted** on their student loan debt or had failed to pay at least \$1 on their outstanding student loan debt at any point within the past seven years.

The emotion of fear will likely be the main thing holding a client back from writing up an offer to purchase a home. Even if the client thinks that the home is the most beautiful piece of property that they have ever seen, the thought of trying to come up with enough cash to close escrow and to make monthly payments for a term up to 30 years can be quite fear-inducing and unbearable for many clients.

A relatively small percentage of Americans today have sufficient levels of cash reserves. This is partly why the vast majority of home-purchase transactions in recent years used either an FHA or VA-type home mortgage that required only down payments of 0% to 3.5%. The bulk of home sales in California and the rest of the nation will continue to be for homes that are priced under the maximum loan amounts available for FHA and VA buyers as long as there are not many buyers out there today with 20% or more down payment funds to close escrow.

Two recent studies completed by life insurance company *Northwestern Mutual* and financial publication *Zero Hedge* noted these shocking financial results:

- 50% of Americans do not have access to \$400 cash for any type of emergency situation, including the pandemic.
- 50% of Americans have outstanding balances of consumer debt for things like credit card bills that exceed \$25,000. This number does not include any mortgage balances.
- The average American today with any kind of credit card balance has a balance of about \$6,200.
- 45% or more of U.S. consumers spend almost 50% of their monthly income on debt repayments that are usually at or near just the minimum monthly payments.



How Compound Growth Eliminates Debt

A creative and inspired real estate agent can take this negative consumer debt information and spin it around for their buyer prospects. How is this possible? The agent can teach the client about the magical powers of compound growth at an annual historical rate factor here in California that has proven to be much higher than most other states over the past several decades.

Once again, the fear of unpaid consumer debt is probably the main “anchor” holding the client back from writing up an offer to purchase a home, condominium, or townhome. Yet, the agent can spin their fear of unpaid consumer debt by offering the client hope about the potential of creating newfound wealth opportunities by emphasizing how the client’s home purchase may likely later prove the concept of “let one’s money work hard for you instead of the other way around.”

The business of real estate is built upon **leverage**. The word “leverage” can be defined in at least a few very different ways such as:

“Power, effectiveness - trying to gain more political leverage.”

“The use of credit to enhance one’s speculative capacity.”

“Influence or power that is used to achieve a desired result.”

* Source: Merriam-Webster Dictionary

Agents can promote the word “leverage” in a variety of ways when making their presentation to prospects or clients in person or via advertising. The agent can make a strong point about the fact that the buyer might only need to bring in a few thousand dollars (or less than \$10,000) to purchase the property after formally qualifying for some type of government-backed or insured mortgage loan. The agent, along with the mortgage broker or banker assisting the client, can emphasize that some,

most, or all of these down payment funds may originate from other family members or from credits from the seller's side towards closing costs or repair estimates.

Additionally, the agent can talk about how fast property values in the nearby area have doubled in value over the past several years. By informing the client about how much property values have multiplied, the agent is also showing the client how much future equity gains and overall net worth the client will attain if they close escrow on the property in the near term. If the real estate agent knows that the biggest fear for the client is about how they will one day pay off their \$50,000 in combined student loan and credit card debt, the agent can show them how their property could double in value in the near future *if* it maintains the same annual appreciation growth rates that homeowners have seen over the past few decades. This way, the agent is showing the client that this is an **investment opportunity** instead of just more negative debt that adds no value to one's net worth.

An example of a sales strategy that an agent can use with a client who is having a difficult time deciding whether or not to write up a purchase offer for a \$400,000 home might look something like this:

- The agent pulls out a historical price trend sheet that clearly shows the buyer prospect how quickly property values have multiplied over the past several decades. The price charts can show the same zip code or the real price history for the subject property if it has been around long enough.
- The sales chart or valuation history for median-priced single-family homes in the same zip code could look like this:
 - 1977: \$35,000
 - 1987: \$72,000
 - 1997: \$155,000
 - 2007: \$280,000
 - Current List Price: \$400,000

In this example, the current list price is \$365,000 higher than the sale price 40 years ago. Or, the property is more than 11 times higher than the very first purchase price. The agent can then make a strong point that 30 years from now the new mortgage loan will be free and clear, i.e., fully paid off.

If the property increases in value at the same appreciation rates as it has over the past 40 years, then the property could one day be worth \$800,000 to \$1 million dollars or more. Inflation is usually a destroyer of wealth and akin to a hidden form of taxation. As the purchasing power of the dollar continues to decline, a weaker dollar buys fewer new assets. However, inflation can be one of the greatest allies for the ownership of real estate partly since property values have consistently maintained an appreciation pace slightly higher than the government's reported annual inflation rates.

The agent should emphatically state that inflation may continue to cause rent prices to skyrocket, especially in some of the more prime California regions, and create more wealth for landlords and other real estate investors. The agent might also discuss how groceries, gasoline, and other weekly consumer expenses may only get more expensive over the next few years. The solution to this inflation madness is the ownership of real estate, an exceptional hedge against inflation.

One of the quickest ways to persuade someone about the magical powers of compound growth is to teach them about the **Rule of 72** theory. This mathematical forecast equation is a way to show clients about how the potential future rates of appreciation for an asset or investment opportunity will potentially double their original principal amount invested. The investor or salesman will take the anticipated annual return rate and divide it into the number 72 to arrive at the length of time that it might take for the original principal amount invested to double in value (e.g., an investment that generates a 10% annual rate of return will double in value in 7.2 years ($72/10 = 7.2$ years)).

One of the best ways to forecast future appreciation trends is to look back at past historical rate growth trends. For example, let's say that a certain category of stocks that is associated with the communications industry has grown at a pace of 10% per year over the past five years. The stockbroker will then say to the client if he plans on using the Rule of 72 formula:

"You should consider investing \$10,000 in this stock because the stock price may double in value in the very near future. Historically, this stock has averaged a 10% annual growth rate. If the stock continues to increase at the same 10% annual return pace, then your \$10,000 investment would grow and double in size to \$20,000 in just over seven years."

With real estate prices, the magical powers of compounded returns can be even more impressive. Now, let's use the \$400,000 purchase price offer example and the Rule of 72 formula together as a way that the selling agent can inspire the fearful buyer to actually sign on the purchase contract.

Agent:

*"We have an opportunity today to write up an offer to purchase this beautiful home that is priced well below market value as you could see when I showed you the five sales comps (comparable properties). Historically, this home has appreciated and compounded in value at least 10% per year. Using the Rule of 72 formula that I was showing you earlier, the home could double in value to \$800,000 **if** it appreciates at the same 10% annual appreciation pace in just over seven years."*

In seven years, your mortgage principal debt will have dropped somewhat due to the amortization schedule of the mortgage payments. While the mortgage debt may not drop a significant amount in the first seven years, it will accelerate and pay off much more quickly in the remaining 23 years. If this home does double in

value in 7, 10, or 15 years, it will be equivalent to gaining an extra \$400,000 in profit or equity gain. While I understand that your main financial concerns are related to how you will one day be able to pay off the \$50,000 in student loan and credit card debt, the equity gains from this property may allow you to easily do that at some point in the future.

Conversely, the downside risk for this investment opportunity is minimal for the following reasons. First, the new monthly mortgage payment (principal, interest, taxes, and insurance) is less than what you are paying in rent today partly because mortgage rates are still near all-time record lows. If you decide to wait for another property, we cannot be sure that the mortgage rates in the near term will still be as low as the rates are this week. As another plus, you will get tremendous tax write-off benefits with the mortgage interest payments.⁴

Plus, you are only risking a relatively small amount of capital to tie up and purchase this home thanks to the low down payment options from the FHA loan that your lender found for you. California is a trust deed state that does not usually allow lenders to pursue borrowers for any of their financial losses related to purchase money loan transactions for properties that go all the way into foreclosure. I understand that you have a solid credit payment history, but it is wise to analyze the potential positives and negatives associated with any investment. Other states around the U.S. do allow their lenders to obtain deficiency judgments if the lender loses money on the deal after the borrower walks away from the property due to such reasons as job losses, divorce, or medical bills.

So, you can move into your “dream home” in the next couple of

⁴ At the time of this writing, a new tax bill was recently passed by Congress and signed into law. We do not yet know the precise tax ramifications for homeowners. Make sure you check with a knowledgeable tax professional before you discuss tax write-offs with your clients.

months if you sign the purchase contract today that is hopefully accepted. After escrow closes, you can be on your way to creating wealth opportunities that allow you to pay off any and all consumer debt and raise your family in a safe neighborhood near some of the best schools in the county. Are you ready to make your dreams come true by signing the contract today?”

With this sales strategy above, the agent knew what the primary anchor was that was holding back the client from signing the contract. The only reason why the agent knew about the client’s valid concerns was that the agent kept asking lots of empowering questions that inspired the client to share her fears, hopes, and dreams with the agent. Instead of avoiding the topic of debt, the agent made it a central part of the process by showing how the equity gains from real estate ownership was perhaps the best way to eliminate consumer debt and improve net worth.



As such, a good way for an agent to overcome a client’s main objection (or “anchor” holding them back) is to bring it up first, point out ways that

these objections or obstacles may be minimized or completely neutralized, and show new ways to find valid solutions that the client probably had not thought about before.

Which mathematical forecast can show a client how fast their principal could double in the future?

Shortening Attention Spans

Real estate agents need to understand, first and foremost, that they must quickly capture someone's attention when advertising or meeting a person for the first time. Twenty or 30 years ago, agents had less competition to capture their customers' attention because social media did not exist, and the internet was still in the very early stages of existence. The most creative forms of advertising methods are remembered more than one day later by prospects. To make people remember their ad, the agent must capture their attention by standing apart from the other nearby real estate agents.

Microsoft, and some of its affiliates, conducted some detailed studies about shortening attention spans for both Americans and Canadians dating back to the years 2000 and 2015 for comparison purposes. Researchers in this attention-span study took a survey of 2,000 participants, and also closely studied the brain activities of 112 other parties using electroencephalogram machines ("EEGs"). These EEG results would show the researchers whether or not the test subjects were responsive to the information shown to them and if it truly grabbed their attention.

When the study was first conducted in 2000 up in Canada, the results were that the average person's attention span was 12 seconds. Fifteen years later in 2015, the same Microsoft team held the same type of attention-span study. Amazingly, the researchers discovered that the average attention span had fallen dramatically down to just seven (7) or

eight (8) seconds. Since a goldfish is thought to have an attention span closer to nine (9) seconds, the researchers had fun with the fact that the average American and Canadian might have attention spans shorter than a goldfish!

Various other studies have shown that the youngest generation of Americans today tends to have the shortest attention spans. Fewer and fewer young Americans will read a printed newspaper or book, but they will read a blog or an eBook if the content quickly captures and keeps their attention. Agents need to be cognizant of the fact that target marketing strategies should be placed online and in print media as a way to promote the agent's products and services to a much larger, but a much less attentive audience.

AIDA

The importance of advertising for real estate professionals is quickly defined, most appropriately, by way of the acronym AIDA:

Attention: With only eight (8) seconds or so to grab someone's attention, the agent must be very creative with bold headlines, colors, catchy phrases, photographs and other eye-catching images, plus positive trigger words or designs that motivate readers to continue reading the ad beyond just the first line or two. Sometimes, a humorous message might make someone laugh at the first sight of the heading prior to making them more open to the properties or services that the agent is offering.

Interest: The ad should result in arousing an increased interest in the property or service. One of the best ways to do that is to make someone more curious as they start to imagine the future benefits associated with owning the property being advertised. For example, an agent might promote how much fun the weekly golf parties are at the master-planned golf community resort for people over 55 where the listed property is located. Within the ad, the agent has a photo of several men and women

laughing, playing cards, and enjoying drinks together. For someone who is lonely, widowed, or recently divorced, the person may be very interested in making new friends and even meeting a potential romantic partner.

Desire: Once the person's attention and interest are attracted, the ad should appeal to the reader's emotions or feelings. While the negative emotion of fear can push people away from others or products, the positive emotion of love may serve to attract people. It was the fun lifestyle in the ad sample above that is targeted towards retirees or older adults. The ad piqued or stimulated the ad reader's curiosity perhaps more so than the property itself. The field of real estate is more about establishing business relationships built upon trust and confidence, so why not promote relationship opportunities for new clients when selling properties as well? Few things in life create more desire and a willingness to take action than the prospect of love or the establishment of new connections.

Action: The ad should inspire readers to take action. For real estate agents, the most desired action is for the reader or prospect to contact them. As such, the ad should include as many different ways for readers to contact the agent as possible, with options such as the brokerage firm's physical address, the agent's cell phone number and email address, and any links to websites owned or managed by the agent.

Blind Ad: A real estate blind ad is an advertisement that does not identify the person or professional status of the ad-placer but instead only includes basic contact information. In both online and print media ads that are about homes listed for sale, agents *must* clearly identify themselves as a licensed agent. The ad should include the broker's name, the name and license number of the employing brokerage firm, the mailing address, phone number, and the best email address for the agent advertising the property for sale. Otherwise, consumers might incorrectly believe that they are contacting the owners directly. Although blind ads

are commonplace in some print media and online, in most cases, a blind ad is *illegal* and can be cause for license suspension or revocation.

Conversely, an unlicensed person who advertises himself as a real estate professional can face **finest of up to \$20,000** and **imprisonment for up to six (6) months**, per the Real Estate Law. That person may also be at risk of having a civil complaint or lawsuit filed against him by the injured party or parties.

One Click Rule: Consumers who visit an agent's website, online blog, or business page on social media must be able to find the agent's contact information within one click of the lead page. The contact information should include the same types of information that is required to avoid being labeled as a blind ad (i.e., agent's name, employing brokerage firm's mailing address and CalDRE license number, phone number, email address, and website name, if applicable).



AICDC

The Dale Carnegie Professional Sales Course takes the AIDA approach one step further by way of their AICDC concept. Attention, Interest, Desire, and Action are all great first steps in the AIDA sales strategy above. However, there is one more step that is the most important of all for real estate professionals and most other types of salespersons. It is the step known as “Close” (or purchase the product or service). Agents only earn commission income when their clients have closed or finalized a deal with them. None of the other AIDA steps necessarily will lead to the real estate agent collecting some actual income from having had contact with the customer.

Attention: Same as AIDA.

Interest: Same as AIDA.

Conviction: The agent gains the customer’s conviction, confidence, favorable impression, or almost full belief in the product or service being offered for sale by offering them some strong evidence backing up the agent’s claims, such as recent housing statistics or past testimonials from happy clients.

Desire: Same as AIDA.

Close: Sadly, many agents are quite hesitant to ask for the close from the client. A client with piqued interest who is ready to move forward with the deal being presented may have no real value if the agent does not ask them whether or not they are ready to proceed with the deal. The client could be ready, willing, and able to say “yes” to the agent’s suggestion to write up an offer. The agent will only be absolutely certain if he or she asks the client to close the deal.

Assumptive Close Method: During times when the agent and client are meeting in a conference room or coffee shop when the agent is explaining

how the client should make an offer sooner rather than later, the agent should pay close attention to the client's reactions, statements, or body language to determine if the client is ready to move forward. These statements or signs may include:

- The client nodding his head in approval, leaning forward, picking up the contract form and reading it, and affirming what the agent is saying to him.
- The client asking questions about the best offering price.
- The client asking about when he or she can take possession or occupancy of the property.

If and when the client seems ready, willing, and able to make a formal offer, the agent should move ahead with the best closing techniques such as handing the client a pen to sign the purchase agreement.

Five Guidelines to Advertising Properties or Services

Here are some guidelines that real estate agents should consider following when thinking about the creation of a marketing campaign for the advertisement of a listing:

The correct time to advertise: An ad that runs during the holiday weeks when fewer people are thinking about buying homes or many people are away on vacation is probably not the best time to promote a property for sale. A better option might be near the start of the peak spring and summer buying months.

The correct property to promote: For agents with multiple listings that they control or others in their brokerage firm do, the listing for the most attractive and fairly affordable property will probably be a better option than the oldest and most rundown property or even the most expensive property that is listed for sale. Why? There are few buyers interested in

fixer uppers and even fewer buyers who can qualify for a multi-million dollar property. The listed property should be used as a hook to reel in interested buyers for that property or for other similar properties. If most qualified buyers near the agent's brokerage office can qualify for homes priced under \$400,000, then the agent will likely be more successful if he or she promotes properties for sale that are that price or less.

The right market: Is it a buyer's or seller's market during the current economic cycle near the broker's office? If interest rates are too high right now, then there may be more sellers than qualified buyers. If fewer people buy in the fall and winter months, then the agent should consider spending more money promoting properties in the spring and summer months.

The selection of the most effective media source: Should the agent use online targeted ads that will be posted on social media, or should he or she run ads in the local senior publications if trying to sell a home located in a senior (or over 55 or 62 age community)? If the agent is targeting younger buyers and tenants, then the digital media options make more sense. Older folks/retirees may be more responsive to magazines, newspapers, and classified ads that are delivered in the local community. In fact, some *past* market surveys found that people over the age of 50 are more responsive to classified ads than radio, television, or online ads. But the agent should not limit the ads for older people to just those sources because many people in their 50s and 60s and beyond are more tech savvy these days than one would think.

The right advertising technique: An ad placed in a radio broadcast for a local rap music station that is used to promote the sale of a retail shopping center that has a list price of \$10 million would probably do better placed on a local business station instead. This is partly due to the fact that fewer young rap music listeners would qualify to purchase a \$10 million dollar retail mall. However, there might be one radio listener for a business station who might have the funds available to complete the purchase. Other solid advertising techniques may include emphasizing

the prime location of the subject property more so than the building structure itself when the property is older (or promote the good and minimize the bad).

Forms of Advertising

Advertising options for print and digital media include:

- Personal ads that promote the individual agent's services or listings
- Institutional ads that promote the entire brokerage firm's name
- Newspapers (e.g., general circulation daily and weekly, weekly throwaways or classifieds, foreign language, and special interests such as for people who live in apartment buildings)
- Local and national magazines
- Television
- Radio
- Online blogs, social media target ads, and website links
- Printed newsletters mailed out to former clients and new prospects
- Outdoor advertising such as posted signs or billboards
- Email advertising blasts (be cautious of spam laws though)
- Direct mail via postcards and letters
- Press releases
- Specialty gift offerings
- Display advertising (or large ½ or full page ads in newspapers or magazines)

- Telephone lists that do not include numbers that are on the national Do Not Call registry

Agents these days must be extra cautious when sending out information using email marketing strategies. The practice of sending unwanted commercial email in large quantities such as hundreds, thousands, or millions at a time is known as **spam**. Some people will use email filter systems that automatically grab incoming unwelcome email (usually from an unrecognized source) prior to redirecting the spam into some type of “junk” folder. Because some types of spam may contain malware (or computer viruses) that can infect a computer system by either crashing the entire system or allowing the spam sender to steal valuable content, passwords, and credit card numbers, more and more people today are likely to file complaints with the Federal Trade Commission (FTC) just like they do for unwanted telemarketing calls.

The main steps that consumers take when filing spam complaints with the FTC and their own email provider include:

- Forwarding a copy of the perceived spam email to spam@uce.gov.
- Forwarding a copy of the spam to the customer’s main email provider. At the top of the message sent, the customer should note that they are complaining about being spammed. Often, the email provider will have buttons that allow consumers to mark the message as “junk mail” or “spam” without needing to follow up with a separate complaint to the email provider’s customer service department.

Agents need to truly understand how quick and easy it is for consumers to report telemarketing and email spam abuses literally within 30 seconds. The fines for email spam can reach over \$40,000 per email sent. Just the fine associated with one email sent to the wrong party can financially bankrupt many people. Now imagine receiving a fine for 10 or 100 spam emails that can add up to \$400,000 (\$40,000 x 10) or \$4

million (\$40,000 x 100).

Under the **CAN-SPAM Act of 2003**, the FTC is in charge of the enforcement of laws and has the authority to levy fines against business owners or other individuals who violate these guidelines. The CAN-SPAM name stands for “Controlling the Assault of Non-Solicited Pornography and Marketing Act.” When the fines began to be levied in 2003, they were up to \$11,000 per email occurrence. As time progressed, the fines increased to over \$40,000 for each email violation.



Criminal penalties for the violation of commercial email laws for some of the worst spam abusers are under the authority of the Department of Justice (DOJ). People or companies that use another person's computer or operating system without their permission to: send out false header or subject matter emails, register for multiple anonymous emails that hide the sender's true identity, send out malware that infects computer systems, or requests the email recipients send large amounts of money under false pretenses, may be sent to prison for a very long time if convicted after charges are brought by the DOJ. Additionally, mortgage brokers who send out false and misleading financial information, knowingly or not, can easily be criminally prosecuted and hit with very large financial fines and lawsuits.

Specialty Gifts: Some gifts or promotional giveaway items can be exceptional ways for agents to attract new clients if done correctly. However, if the agent does not fully disclose in the original ad what the prospect is required to do when attending a seminar presentation or some other event, the agent can get into some serious legal and licensure trouble. The gifts being offered by the agent to prospects who attend their seminars, open houses, tea parties, or even golf events may include calendars, desk pads, monogrammed towels, and even drawings for prizes such as exotic vacations to Hawaii.

Companies that sell timeshare offerings have both positive and negative reputations related to the offering of incredible prizes to prospects who show up to sign in at the seminar. What some timeshare companies fail to do in their advertisements that promote these gift-giving events is to actually tell the prospect that he or she must sit through a 2-hour presentation before they even have a chance to qualify to collect or win a decent prize.

Truth-in-Lending Act

MISSION: Consumer Protection

LAW: 15 U.S.C. §§1601-1667 (f), as amended

“This Act (Title I of the Consumer Credit Protection Act) authorizes the Commission to enforce compliance by most non-depository entities with a variety of statutory provisions. Among other requirements, the Act requires creditors who deal with consumers to make certain written disclosures concerning finance charges and related aspects of credit transactions (including disclosing an annual percentage rate) and comply with other mandates, and requires advertisements to include certain disclosures. The Act has been amended on numerous occasions, adding requirements for credit cards and open-end credit; for mortgage credit such as ability to repay standards, loan origination, anti-steering, appraisal independence, and mortgage servicing; and others. A number of laws amending and enforced under this Act are listed separately.”

Real estate agents who work as selling or leasing agents must also be familiar with Truth-in-Lending Act guidelines just like mortgage brokers and bankers should clearly understand. Most real estate purchase transactions involve some type of third-party funding source from a local community bank, credit union, savings bank, or even from the seller as a form of a new first or second mortgage or a wraparound mortgage (land contract or AITD).

The Truth-in-Lending Act (TILA) was one of the first federal laws that was enacted back in 1968 to better protect consumers in their business dealings with lenders and creditors. TILA was implemented by the Federal Reserve Board by way of a series of regulations over time that first began with **Regulation Z (12 CFR Part 226)**. The full disclosure of the cost of credit being charged to the consumer is one of the root reasons for the creation of TILA.

TILA also falls under the **Consumer Credit Protection Act**. Both of these acts ensure that lenders fully disclose their terms of credit being offered to the general public in some type of uniform or standardized way so that consumers make informed choices when comparing and contrasting financial offers from mortgage, credit card, automobile, and other lenders. Unfair billing practices are also covered under these acts as a way to protect people from having their monthly rates go from an initial start rate of 5% for what the borrower thought was a fixed-rate loan up to 15% as an adjustable-rate loan within a few months or years.

Lenders, mortgage brokers, and real estate agents must fully disclose in their advertisements about properties or mortgage loan options at least the following details:

- Annual Percentage Rate (APR);
- term of the loan (10, 15, or 30-year mortgage); and
- the total borrower's costs to be paid upon closing.

TILA was designed to apply to most types of consumer credit such as both **closed-end credit** (mortgages or automobile loans) and **open-ended revolving credit** (credit cards, home equity lines of credit). A main intent behind the passage of TILA was to protect consumers from receiving inaccurate disclosure notices or contracts as well as to clampdown on unfair business practices on the part of the lender or mortgage broker.

Prior to the issuance of new TRID guidelines that will be covered in other sections of this course, the old Truth-in-Lending borrower's statement would be mailed to the borrower within three (3) days of the client's completion of the mortgage-loan application (or 1003 form). The primary purpose of the issuance of this Truth-in-Lending statement was to fully disclose all of the proposed costs, rates, and loan terms being offered to the borrower by the financial institution or mortgage brokerage office. If the customer did not like the terms of the proposed loan offer, they had the right to quickly back out of the deal.

The Truth-in-Lending Act, as well as other consumer protection laws, are enforced by the Federal Trade Commission (FTC). It is ultimately up to the FTC to try to prevent fraud, deception, and unfair business and advertising practices. The FTC also regulates telemarketing and email spam. Whether the business owner or real estate agent contacts the prospect directly at first by way of “cold call,” email, or regular mail, or the prospect contacts the business owner or agent after responding to their ad, the FTC’s job is to ensure that the consumer is protected.

Chapter Five Summary

- The costs of advertising should be viewed by agents as more of an investment than an expense. An effective marketing strategy can generate 1,000% to 10,000% cash-on-cash returns.
- **Institutional advertising:** This type of advertising attempts to create a favorable impression of the real estate brokerage firm, the employing broker, and the salespersons who work under the broker’s license. It is typical of larger franchise brokerage offices.
- **Specific advertising:** This kind of advertising is also called **operational advertising**. An example would be when an agent promotes his listed property for sale.
- The two wealthiest generational groups in America that own and control the most real estate and cash are the *Baby Boomers* (born between 1946 and 1964) and *The Greatest Generation* (born prior to 1946).
- Since 2015, Millennials (born between the early 1980’s and early 2000’s) have represented the largest generational group of homebuyers and tenants in the nation. Millennials are projected to peak in population close to 81 million by 2036.

- Combined outstanding residential and commercial mortgage-loan balances exceed \$9.86 trillion nationwide, \$1.6 trillion for student loans, and over \$1 trillion each for credit card bills and automobile loans, respectively.
- The average American today with a credit card balance has a balance of about \$6,200. An estimated 45% or more of U.S. consumers spent almost 50% of their monthly income on debt repayments. Agents need to know these figures when learning about how debt-to-income ratios can make or break their buyer's mortgage request.
- The **Rule of 72** is a quick way to learn about the magical powers of compounded investment returns by dividing 72 by the current or projected annual interest returns. For example, an investment (or principal) that generates 10% interest returns each year will double in size in 7.2 years ($72/10 = 7.2$ years).
- With the average American today potentially having an eight-second attention span, the sales technique of **AIDA (Attention, Interest, Desire, and Action)** should be as eye-catching as possible.
- **One Click Rule:** Consumers who visit an agent's website, online blog, or business page on social media must be able to find the agent's contact information within one click of the first page.
- Under the **CAN-SPAM Act of 2003**, the Federal Trade Commission (FTC) oversees legal enforcement and has the authority to levy fines up to \$40,000 for each violation, especially for unsolicited email or spam.
- The **Truth-in-Lending Act (TILA)** was enacted to protect consumers from unfair prices and fee charges related to most types of consumer credit such as both **closed-end credit** (mortgages or automobile loans) and **open-ended revolving credit** (credit cards,

home equity lines of credit). TILA was passed with the intent to improve financial disclosure forms for consumers, and is enforced by the FTC and other agencies.

Chapter 5 Quiz

1. What type of advertising is meant to create a favorable image of the real estate brokerage firm?
 - A. Personal advertising
 - B. Blind advertising
 - C. Institutional advertising
 - D. Target marketing

2. A type of advertising that promotes an agent's listing of a home with photos and list price is called _____.
 - A. Non-geographic
 - B. Specific advertising
 - C. Operational advertising
 - D. Both B and C

3. Over the past 30 years, which generational group purchased the most properties nationwide?
 - A. The Greatest Generation
 - B. Baby Boomers
 - C. Generation X
 - D. Generation Y

4. According to the National Association of Realtors, what percentage of Millennials will hire a real estate agent to complete their purchase?
 - A. 50%
 - B. 65%
 - C. 82%
 - D. 90%

5. What is the estimated amount of outstanding unpaid student-loan debt nationally for 2017?
- A. \$1.6 trillion
 - B. \$1 trillion
 - C. \$540 billion
 - D. \$140 billion
6. What would be the best mortgage loan option for a client with a high debt-to-income ratio?
- A. Conventional
 - B. FHA
 - C. USDA
 - D. Conforming
7. Which mathematical forecast can show a client how fast their principal could double in the future?
- A. Leverage
 - B. Rule of 72
 - C. Cap rate
 - D. Amortization
8. What type of ad does not clearly identify the agent?
- A. Institutional ad
 - B. Personal ad
 - C. Blind ad
 - D. Non-targeted ad
9. A consumer must be able to quickly find the agent's contact information on their website under the ____.
- A. Principles of contacts
 - B. One click rule
 - C. Marketing principles
 - D. 10 second rule

10. Under the CAN-SPAM Act of 2003, which agency is in charge of the enforcement for agents who violated spam laws?

- A. Federal Trade Commission
- B. CalDRE
- C. California Attorney General
- D. Governor's office

11. The Truth-in-Lending Act (TILA) first began with which act?

- A. Fair Credit
- B. National Disclosure Act
- C. Regulation Z
- D. Civil Rights Act

12. TILA applies to what types of loans?

- A. Private money
- B. Closed-end credit
- C. Open-ended revolving credit
- D. All of the above

Answer Key:

1. C	6. B	11. C
2. D	7. B	12. D
3. B	8. C	
4. D	9. B	
5. A	10. A	

CHAPTER 6

Listings - Presentations and Types

Overview

To build a long and successful career, real estate agents must list properties, specialize as a buyer's agent prior to finding their clients properties, or both. With a listing, an agent has more control of the transaction and can promote the property so that other agents can bring in their own buyers or customers will show up on their own to view the property. One listing can generate multiple future transactions for the agent as we will learn in this chapter. We will address the various components involved in the listing presentation process as well as how to best service the listings so that the properties sell as quickly as possible.

Finding Sellers

One of the main jobs for real estate agents is to find a willing and motivated seller who is ready to work with them. Once interested parties say that they are thinking about selling their home, the agent must quickly and effectively act to convince the property owner that he or she is the right person for the listing job. Sellers must have at least some faith in the agent's abilities to promote their properties for sale to the widest and largest audience possible, so the agent must show them that they understand the latest home price trends as well as the most creative ways to market the property.

There are a number of ways that a new or experienced real estate agent can find sellers ready to list their homes. Homeowners who are facing serious code violations or impending bankruptcy or foreclosure actions can be motivated sellers who are ready to list right away. Other listing source options may include:

1. Sphere of Influence: Agents should start with their innermost circle of friends and family prior to expanding outward to “friends of friends” and “friends of friends of family.” As we have discussed, the most important step in this process is to *ask* friends, family, co-workers, past schoolmates, and acquaintances at houses of worship or social clubs if any of them are interested in selling their homes. This sphere of influence networking concept can be one of the best starting points for solid referrals that later lead to closings.

2. Farming: The agent will usually specialize in one or more selected regions for a small to large geographical farm process that includes dropping off four-color postcards or knocking on doors several times per month. Some residents will not answer their door if they see a stranger there trying to sell them a product or service while others might be quite welcoming and very interested in hearing about the latest home price trends that can help or hurt them.

3. Cold Calls: The most important part of the cold call process is making sure that the homeowner has not placed their home or cell phone on the national Do Not Call registry list. Otherwise, the agent may be faced with fines of thousands or tens of thousands of dollars. For anyone else on the list, the agent can call the owners in an attempt to set up a meeting with them at a later date so that the agent can show the owners the latest price trends and a potential marketing strategy to use to get the best price for their home.

4. Expired Listings: Agents can easily find expired listings nearby. If so, the agent can call the property owner to find out what happened with their last listing, why they didn’t renew it, and then go in for the close by asking for the next listing opportunity.

5. For Sale By Owners (FSBO): Agents can go visit homes listed by the owners at FSBO properties. After building a rapport and sharing updated marketing information with the homeowner, the frustrated FSBO owner

might later decide to hire the agent to handle their listing because it is taking too long to sell their home on their own.

6. Ads: The agent can place some affordably-priced classified ads in local newspapers, on online sites like *Craigslist*, *Oodle*, *Close5* (formerly *eBay Classified*), *US Free Ads*, and *PennySaverUSA*. Most of these sites have millions of users who visit them each month. Many ads placed on these websites can be targeted to regions by specific zip codes, cities, counties, or states.

Interview Preparation

Sellers may interview several agents in the local area before deciding which agent is the best for them. Initially, agents may make first contact with the client on a telephone call or via an email or text. While any of these communication options can be beneficial to the establishment of first contact, the key is to set up a face-to-face meeting as soon as possible with the seller prospect.

Many sellers today will “shop around” for two or three agents before deciding which agent to appoint as their primary listing agent. Sellers need to be persuaded or convinced that the agent will be prepared and knowledgeable enough about their property, surrounding properties, and the neighborhood, in addition to the most creative ways to effectively market their property. To sellers, the most important outcome is usually to receive the absolute highest net price in the shortest amount of time possible.

In these face-to-face meetings with one or more agents in the agent interview process, the property owner will be looking at the agent’s strengths and weaknesses. As such, it is imperative for the agent to dress professionally and be well-prepared for the interview process.

In high school or college, the best-prepared student who has done the

most homework will likely receive the highest grade from the teacher. In this case, the “teacher” is the seller who will determine whether the agent receives a passing grade (i.e., gets the listing) or a failing grade (i.e., no listing). A truly successful listing interview is one that is personalized for the homeowner’s needs and tailored to the homeowner’s property.

Presentation Preparation

Shortly after the agent has set up a formal face-to-face appointment time to meet with the seller, he or she must start their homework process. The agent must thoroughly research the subject property that is about to be listed as well as the latest sales and listing price trends nearby. Agents must make sure to give themselves enough time to do their market research between the initial phone call with the selling prospect and the actual appointment. An agent who is too eager and offers to show up just one hour after the phone call with the selling prospect will probably not have enough detailed data with him to persuade the seller that they really do understand the market trends in the area and the best list price for the seller’s home.

Finding The Seller’s Motivation

Before attending the scheduled listing appointment with the seller, the agent should find out the true needs and interests that are inspiring the seller to list their property for sale in the near term. Asking questions about why a person wants to sell their home now also will help the agent determine how serious and motivated the homeowner is to sell their property. The agent can later build his or her sales presentation around the selling prospect’s needs and interests.

Some questions that an agent on a phone call or in a private one-on-one meeting might ask the selling prospect include:

“Why do you want to sell your property now?”

A salesperson of any type of product or service will usually be more successful if they truly understand the needs, interests, and desires of his or her customers. Someone who tries to sell a product or service to a client who does not have any interest in or need for that product or service is probably wasting his or her time. An exception to this rule is if the prospect refers the salesperson to another friend or family member who might actually have a need for his or her product or service.

Often, selling prospects are especially motivated to sell their home as quickly as possible due to family or job changes, such as an impending divorce, a job loss, the death of a loved one, imminent foreclosure, serious disputes with the neighbors, or a desire to retire and move out of state to be closer to family. Other times, the selling prospect may not be that eager to sell right now as they just want to test the market in an attempt to find out what their property value is today. Or, they may be completely unrealistic about the market values or selling prices in the area, and hope to set a new record selling price on their block just to tell their friends and family even if it takes a year or two to sell.

“How soon do you want the property to close escrow?”

A motivated seller will usually be more open-minded and agreeable to an offer of a shorter 30-day close and a more realistic list price. Other sellers who are not as motivated or who need a few months to finish up repairs around the house, complete some job assignments, or allow their children to finish up the school year before they move to another school district may prefer a much longer listing and escrow period that can last several months or longer.

If the seller wants the property to close escrow six (6) months after the initial listing date, then it may be wise for the agent to suggest holding off on listing the property until a few months later. Properties that are listed for sale too long can sell for much lower prices because other agents and

buyer prospects may think that there might be something wrong with the listed property. A home listed on the MLS that shows a DOM (Days on Market) number that is 180 days instead of one that is just 10 days might look like a troubled property to some agents and buyers. If so, they may decide to not even bother to view the property.

“Where are you planning to move to after the home closes escrow?”

This question as well as the next two questions below may help open the door to multiple future transactions with the same selling prospect. Unless the seller is planning to move into a guest room with friends and family, the odds are fairly high that they will need a new place to lease or purchase.

“Are you planning to rent or buy again? If so, do you need assistance with some potential new properties to move to after your home sells?”

If the selling prospect is planning to stay within the same geographical region (town, city, or county) where the agent works, there can be some additional opportunities to act as a leasing or buyer’s agent with the seller after the home sale closes escrow.

“How have your past experiences been with other real estate agents?”

This is a solid question to ask so that the agent better understands whether or not he or she will be competing with past agents who have assisted the client. If the seller has a very close friend who has acted as their agent on multiple transactions over the years, then that can be a worrisome sign. However, past relationships with other agents that turned sour means that the seller is very open to establishing a brand new agency relationship.



Homework Preparation

Before meeting with the selling prospect in person, the agent must complete a detailed analysis of the subject property and the most-recent sales and listing comparables that took place recently, especially within the last six (6) months. This preparation is like studying for a midterm exam in school. Instead of a solid grade received for the homework preparation, the agent is trying to create income from the sale of this property. In this case, the “homework” is literally work associated with a home.

Some of the most important tasks to complete in the homework-preparation process include:

- Property research
- Walking through the home in person and around the neighborhood
- Completing a Comparative Market Analysis (CMA)
- Preparing a marketing plan

Property research: The agent should start by gathering as many details as possible about the subject property, including any legal description documents that can be found on public records, property tax assessment information, plat map, and a **“chain of title”** history that can be provided by a nearby title insurance company. A chain of title will show all of the ownership changes and lender or beneficial interests for the property as far back as when the home was first built. The easiest and best way to find a property profile for a specific property is directly from a local title insurance company.

Either before or shortly after the seller has agreed to list the home with the agent, these items should be requested from the seller so that the agent can be as fully informed as possible about the home:

- A copy of the latest mortgage payment statement (or at least ask for a verbal response to determine the amount).
- A copy of the most-current property tax bill (first or second half installment).
- Any documents related to special assessments, bond charges, or Mello-Roos fees that are paid in addition to the standard property taxes.
- A copy of any existing CC&R documents that can be reviewed by the agent and shown to prospective buyers and their buyer agents.
- Utility bill statements for the property.
- A copy of a property key for the lockbox for personal showings.

Walk through the home and around the neighborhood: An agent should become quite familiar with the property they are attempting to sell as well as the surrounding neighborhood communities. With a camera or Smartphone camera in hand, the agent should take a number of interior and exterior photos of the subject property and neighboring properties,

parks, beaches, or schools nearby. These photos may later be used on the MLS or on the agent's personal website when promoting the property for sale.

Sometimes, an owner and/or listing agent may decide to hire a home inspector to walk through the property for some older homes *before* it is listed for sale. The appointment of a home inspector can help the seller and listing agent determine if the property has some serious defects that must be fully disclosed to buyer prospects. If so, the agent should walk through the property with the home inspector, ask a lot of questions, and take notes.

Completing a CMA: Soon after the agent becomes more familiar with the property and surrounding neighborhood, it's time to create a comparative market analysis for the owner. As noted before in other sections of this course, the CMA will include recent sales comparables for similar homes (size, shape, age, amenities) that have sold within the past six (6) months. If there haven't been enough similar properties sold within the past six months, the agent might have to find some older sales comparables, home listings that have expired, or more-recent listings to use as potential comparables for the subject property.

The primary purpose of the CMA report is to help both the seller and agent find a listing price that is reasonable as compared with other nearby properties. Under the economic theory known as the **Principle of Substitution** that is a core basis for the market data approach to appraisal, the maximum value for a property is usually established by the cost of acquiring an equally desirable or equivalent substitute property that has the same use, style, and income potential. If there are five properties in a master-planned community with identical floor plans, square footage size, bedroom and bath counts, and the exact same year built by one developer, a buyer will most often write up an offer to purchase the one that is most affordable.

Preparing a marketing plan: Sellers typically like to be bedazzled or impressed with an agent's proposed marketing plan. Some new agents might only have a few hundred dollars for their marketing budget while other, more experienced brokerage teams of multiple agents and assistants, may have \$1,000 or more to spend on a creative multimedia advertising campaign that will flood the town with flyers, postcards, online ads, and even a billboard on a busy street.

Three of the most important factors for an agent to consider when preparing a marketing plan to sell properties or services include:

- The target audience
- The messaging promoted in the ad
- The agent's available budget

The agent should discuss all of the different ways they plan to promote the property for sale. Most marketing plans will include the basics such as the placement of a For Sale sign on the front lawn, the listing of the property on the MLS and possibly other real estate marketing systems, and weekly or monthly "broker caravans" (a time when brokers and agents follow each other in cars to visit the most-recent listings in person; this is also called a **"broker preview"** or a **"brokers' open"**) and Open Houses. Other more extravagant marketing proposals can include radio and television commercials, interior videos with exterior drone shots of the property and neighborhood, the creation of thousands of four-color postcards, and other strategies.

Sellers will likely be more impressed with an agent who they believe is the most enthusiastic about their property and who will spend the most time marketing their home. Some agents may have 10 other properties listed for sale and probably don't have as much time to solely focus on the seller's new listing. Other agents may have no listings in their pipeline and are in desperate need of generating new commission income as soon as possible. (An educated seller will probably ask the agent how many listings they have right now!) Those with fewer listings will probably be

thinking or working on the most effective ways to market and sell the home almost every waking hour until the property finally closes escrow.

Other determining factors that cause sellers to select an agent to list their property is the likeability factor. Agents who are cordial, smile, and are respectful to their clients are more likely to be appointed as their listing or buyer's agent. Often, an agent and client will work together for several months with many phone calls between them. Agents who are rude, obnoxious, or condescending to their clients are ones that may eventually run out of clients to work with due to their disrespectful and unfriendly behavior. A likeable agent who is new to the business may be hired just for their personality and friendliness over another agent with 30 years' experience who is not very likeable in person or on the phone.

Listing Package Components

The agent should arrive to meet with the owner at the property being listed, if possible, when making their listing presentation in person. The items that the agent should consider bringing to this first meeting are as follows:

- A copy of the personalized CMA report that should be in color.
- A cover letter from the agent that is addressed to the client.
- A copy of the agent's resume that highlights their past accomplishments, license designations, education, work experience, and awards.
- Background information about the agent's employing brokerage firm that includes their successful track record in the community.
- A detailed list of past properties sold, listed, or leased.
- A list of testimonials from happy former clients.

- A sample of potential flyers, brochures, or postcards that will be used in the marketing plan.
- A checklist for the seller to help them prepare to get the property ready for sale.
- A proposed selling net list (or “net proceeds to seller”) that details the possible closing costs and total amount of net profit that the seller may walk away with at the closing.
- All of the listing and disclosure forms that will need to be completed and signed by the seller and agent.



Preparation of the Seller's Net Sheet

The **estimated seller's proceeds** or **net sheet** is presented to the seller by the agent or escrow officer to show the seller what he or she may walk away with in cash after all liens and costs have been paid off in full concurrently at the closing. Obviously, most owners want to net the highest amount of cash possible from the sale of their property. The net sheet presented will either confirm the possibility of a huge profit margin for the seller or it will temper or restrain their expectations so that they are a bit more realistic.

Owners who receive much less money from the sale of their property than they had expected may become very disappointed or angry with their agents for persuading them to list the property at a lower price than they had originally wanted. Unhappy sellers can later lead to more problems during and after the escrow process. An effective agent will point out as soon as possible how high the closing costs and lien payoff amounts will be so that there are not any unpleasant surprises at a later date.

Brokerage, escrow, and title insurance offices may all offer computer spreadsheet programs that quickly calculate the seller's costs and lien payoff amounts. The agent will then fill in the details himself or give the numbers to the escrow or title officer so that their office can find it in the estimates. To be accurate, the agent needs the most-recent mortgage loan balance amount, a copy of the latest property tax bill or the verbal numbers, any details about judgments or other types of liens on the property, and a reasonable listing price to add towards the top of the seller's net sheet. Since so many of the other fees are based upon the selling price such as title, escrow, and documentary transfer taxes, the seller's net sheet should be fairly accurate at the time of presentation to the seller.

The seller's net sheet may be prepared online by filling in the blanks or by using a pen or pencil. The easiest way is normally to complete the details

online in just a matter of minutes. The main items that are usually required to complete the seller's net sheet are as follows:

Selling Price (\$)
Projected Closing Date
Broker Fee (% / \$)
Property Tax (% / \$)
1st Payoff Loan (% / \$)
2nd Payoff Loan (% / \$)
3rd Payoff Loan (% / \$)
Escrow Fees
Title Insurance Fees
Third Party Fees (Appraisal, Home Inspector, etc.)
Other Costs & Credits
Total Net Proceeds

Listing Contracts

The agent should thoroughly review the listing contract details and options with the seller in person. The agent should go over every major provision in the listing agreement with the client while answering any questions they may have about the agreement and the process. If the client does sign the listing agreement, agency disclosure, and any other property disclosure forms, the agent should be sure to leave copies with the client.

An agency relationship is officially created between the agent and client once the listing agreement is signed. The agent must provide a copy of the agency disclosure form to the client as well.

The signed (or executed) listing agreement becomes a legally binding

contract that grants powers and authorizes the appointed agent to serve as an agent for the principal in certain specified real estate activity.

Factors that can influence the listing price besides the available supply and demand trends include the condition of the property and the urgency of the sale (or the seller's motivation level).

Elements of a Contract

All real estate listing agreements in California are legal contracts. To make a valid and enforceable contract, there must be competent parties, a lawful object, mutual consent or agreement between a willing and able buyer and seller, and some type of consideration.

A listing agreement must be in writing for it to be enforceable, according to the Statute of Frauds and state rules such as **California Civil Code §1624**:

(a) The following contracts are invalid, unless they, or some note or memorandum thereof, are in writing and subscribed by the party to be charged or by the party's agent:

* * *

(3) An agreement for the leasing for a longer period than one year, or for the sale of real property, or of an interest therein; such an agreement, if made by an agent of the party sought to be charged, is invalid, unless the authority of the agent is in writing, subscribed by the party sought to be charged.

(4) An agreement authorizing or employing an agent, broker, or any other person to purchase or sell real estate, or to lease real estate for a longer period than one year, or to procure, introduce, or find a purchaser or seller

of real estate or a lessee or lessor of real estate where the lease is for a longer period than one year, for compensation or a commission.”

An oral listing agreement offers an agent very little to no protection whatsoever due to the fact that a listing must be written or a broker cannot enforce or demand compensation of a commission if the selling principal later changes his or her mind.

The **consideration** that is offered by the agent in the listing agreement is the broker’s promise to work as hard and effectively as possible in order to find a “ready, willing, and able buyer.” That promise is in exchange for the seller’s promise to pay a previously mutually agreed-upon commission percentage rate based upon the selling price that is later accepted. The “promise to use diligence to find a buyer” in exchange for a seller’s “promise to pay” is the legal definition of a **bilateral agreement**.

What is the main consideration offered by a listing agent in a listing agreement?

Listing Types

There are several different types of listing agreements that can be created between a seller and a listing agent. These forms are generated and sold by numerous publishers as well as individual brokerage firms or corporate franchise headquarters. Signed listing agreements should be submitted to the MLS within **two days** of being signed by the parties.

A listing agreement must have all of the required content necessary for it to be considered a valid contract.

The items that must be included in the listing agreement and agreed to by both the seller and agent include:

- The address or legal description of the subject property.

- The listing price.
- The proposed terms of sale.
- The broker's authority to promote the sale of the property.
- The establishment of the seller's and buyer's brokerage commission.
- The termination date for the listing agreement.
- The initials and signature of the seller.

Property identification: The subject property's address must be clearly identified. This is perhaps the most important part of the listing agreement. Often, a listing agreement is created on behalf of the sale of just one specific property. The agent should include the physical or street address in addition to the legal address (lot, block, tract number or some other designation) from the local title insurance company or public records. For any lengthy legal descriptions that are more than a paragraph or several paragraphs, the agent might consider attaching the legal description as an addendum to the listing contract while noting "see attached" in the space provided for the address in the listing contract.

Terms of Sale: The listing contract should clearly indicate what type of offer the seller is willing to accept from prospective buyers. The list price is the most important term to list in the contract. If the seller is willing to accept a discounted offering price for an all-cash purchase deal and a shorter close of escrow time period, then the seller should let the agent know. For sellers open to carrying some equity as a second mortgage, this seller financing possibility should be included in the agreement with potential terms such as the interest rate and length of the loan term.

Broker's Authority: The listing agreement is a type of employment contract between the selling principal and the listing agent. The listing agreement should specify the agent's expected duties and scope of

authority to act on behalf of the selling principal. This authority that is granted to the agent may include details like how the agent agrees to list the property for sale in the local MLS, advertise the property, hold Open Houses each week, cooperate with buyers' agents, and receive offers and earnest money or good faith deposits from potential buyers.

Compensation Amount: The listing agent is agreeing to do all of this hard work on behalf of the seller in exchange for some type of future compensation or payment. The conditions of the payment should be clearly noted in the contract. The **procuring cause** as it relates to the sale of a property is defined as "the person or agent who brought in a ready, willing, and able buyer to close escrow." As per the terms of the signed listing contract in place, the agent shall be paid the mutually agreed-upon commission rate or a fixed dollar amount at the time of closing. However, in accordance with California Real Estate Law, a seller cannot pay the salesperson a commission directly as only a licensed broker can collect the fees. Then the broker will pay the agent its share of the commission according to the split agreement between the broker and that agent. Should a broker and a salesperson or two brokers from separate offices have a dispute over commission payments, it will be up to the **Labor Commissioner** to resolve the conflict.

Termination Date: It is illegal in the state of California for an agent to provide a client with an **exclusive agency** or **exclusive-right-to-sell** listing contract that does *not* have a definable expiration or termination date. There is no minimum or maximum listing term option that a principal and agent must agree to when filling out the form. Some listing agreements might be as short as 14, 21, or 30 days while others could be 6 or 12 months long.

In theory, there can almost be seemingly infinite variations of a listing agreement because there are so many different components in a property listing that are similar or quite unique as compared with other properties nearby. But there are really just three kinds of basic listing-agreement options that most agents and principals use these days for residential properties. These are:

1. Exclusive Authorization and Right to Sell: This kind of listing agreement is the one that is most preferred by agents because it protects their rights and interests in the property much more than the other listing contracts during the entire length of the listing term. The agent is the sole agent involved in the transaction, and is entitled to his or her entire share of the commission after anyone sells the property. This is true, regardless of whether the agent brought in the buyer, the owner found the buyer, or some other agent came in with a fully qualified buyer who was ready, willing, and able to close escrow in a relatively short period of time.

2. Protection Clause: Agents may still be entitled to the full collection of their commission for properties that later sell after their listing term expires. A listing agent may meet a a potential buyer at showings or Open Houses, or speak on the phone to many prospects during the course of the listing time period. Sometimes, the agent will work closely with his or her buyer prospects for several weeks or months after they first meet one another.

The agent should compile a list of buyer prospects for a type of “protected buyer” list that is akin to a **“safety cause”** that they will hand to the selling principal before this listing term expires. Sadly, some buying principals and sellers try to negotiate with one another as a way to avoid paying a commission to a listing or buyer’s agent. One way to do this is that the buyer and seller will wait until the listing agent’s signed contract expires.

Because home sales are of public record, the listing agent can later find out the name of the buyer for their formerly listed property. Should the buyer’s name match up with one of the names on the “protected buyer” list, then the agent may still be able to collect the full commission because he can prove that he was the **“procuring cause”** who made this deal go through to final sale.

Exclusive Agency: The main difference between this type of listing agreement and the Exclusive Authorization and Right to Sell contract is that the owner does not have to pay a commission to the listing agent if the owner brings in the buyer to close. Some owners will only agree to sign an Exclusive Agency contract because the owner has already spoken to one or more interested parties about possibly purchasing their home well before they met with the new listing agent.

In cases like these where the owner has a list of his or her own “protected parties” that will be excluded from the payment of any commission to the listing agent, the agent should disclose the names of the listed parties on the exclusion list to other agents so that they don’t expect their own commission payment as well. The failure to do so by the listing agent could later make the listing agent fully responsible for the payment of commission to the buyer’s agent even though the listing agent did not make a dime of commission him or herself. If so, this would be an unfortunate financial situation for any listing agent who ended up having to pay for the right to list a property that sold to an unexcluded buyer.

Open Listing: This type of listing agreement is the least favored for most real estate agents. It is a type of non-exclusive contract that gives authorization to one or more brokers to serve as an agent for the principal in a sale, purchase, or lease of a property. The owner will pay a commission only to the agent who is deemed the “**procuring cause**” for the client in that they either found a “ready, willing, and able buyer,” or, they found the right property to purchase or lease.

Under the terms of an open listing agreement, the agent or broker is under no formal obligation to act with diligence when working with the principal. The principal, however, is obligated to pay a full commission if the agent does perform in a way that benefits the buyer and fully meets their needs such as bringing in a buyer with a full-priced offer. Since only one side is truly obligated to perform (the seller), this type of agreement is legally considered a **unilateral contract**.

The first agent who finds a ready, willing, and able buyer who performs is entitled to the full compensation amount that is listed in the open listing agreement (e.g., a 2% or 3% commission based on the final selling price). The closing of the home sale to one of these buyers will automatically cancel any other signed open listing agreements with other agents. Should the owner find their own buyer, then no commission payment is due to any agent.

Net Listings: A **net listing** is more of a commission payment agreement than a traditional listing agreement. The “net” refers to the commission fee collected over and above the seller’s targeted fixed amount of sales proceeds and closing costs that the seller expects at the closing. A net listing can be used in various types of transactions related to land, as well as commercial and residential properties.

The selling principal and listing broker will still select from one of the three main types of listing agreements (open, exclusive agency, or exclusive authorization and right to sell) before moving forward with a net listing arrangement.

Let’s take a look below at an example of a net listing agreement transaction:

Land Price: \$110,000

Estimated Closing Costs: \$3,000

Seller’s Minimum Expected Net Proceeds: \$100,000

Selling Broker’s Net Commission: \$7,000 ($\$110,000 - \$3,000 = \$107,000$); $\$107,000 - \$100,000$ (seller’s net price) = \$7,000 commission

With a net listing in hand, both the seller and listing broker want the property to sell for the highest price possible. For every \$1,000 over and above the seller's fixed net price and the estimated closing costs, it will be equivalent to an extra \$1,000 in commission for the listing broker.

Some agents in past years have been found guilty of fraud or misrepresentation for not fully disclosing their net listing agreement with the seller, or for encouraging the seller to accept a net profit amount that is too low so that the seller would have to make a much larger commission payment. For example, the broker knows that the land value will sell for \$150,000, but strongly encourages the seller to accept a much lower \$100,000 net price after giving the seller the lowest sales comps in the area. This way, the listing broker will later collect a commission closer to about \$47,000 ($\$150,000 - \$3,000 \text{ (closing costs)} = \$147,000$; $\$147,000 - \$100,000 \text{ (net price to seller)} = \$47,000 \text{ commission to the listing agent}$).

California law requires that the broker fully disclose in writing the selling price, the seller's expected fixed net price, and the broker's compensation amount prior to accepting any offer. Many states around the nation consider net listing arrangements to be illegal, partly because these actions seem to go against the broker's main duties as an agent and/or it is viewed as a serious potential conflict of interest. Even though net listings are still legal in California, they are rarely used for any type of transactions these days. Yet some motivated and generous property owners may offer the net listing option to ensure that their listing agent works as hard as possible for a quick sale at a fair price.

Another agent in the area is *never* allowed to contact a homeowner who has an existing listing agreement in place with their own broker in order to try to take away the listing or adversely influence the property owner to change their sales strategies.

Effective Communication

Shortly after the listing agreement has been signed, the agent should stay in close contact with the client to keep them up to date with the latest plans, ideas, or listing appointments. The agent should keep the client informed about the next steps in the listing process such as how the home should be cleaned up or possibly partly or fully staged with rented furnishings. The agent should also let the seller know when the first broker caravan will come by with several agents who want to preview the property before it formally goes online in the MLS.

An agent who keeps the lines of communication open with his or her clients is one who is more likely to instill confidence in the client that the agent is taking an active role in the listing process. One of the main reasons why listings are not renewed after they expire is because there was minimal communication between the client and the agent during the listing term.

The listing agent is not the main licensee who has the financial liability and primary agency duties that must be shown to the selling principal. The main agent involved is that agent's employing broker who might have 50 or more agents working under his or her license. Often, the client may never actually meet the supervising broker in person during a transaction or after it closes escrow.

One way to make sure that some type of communication is conveyed by the employing broker is for them to send out a letter both welcoming and thanking them for selecting their brokerage firm to work on their property transaction. The broker can also convey in the letter that should the client have any trouble reaching the agent in charge of the listing, the client may contact the employing broker directly. This way, the client and listing agent will make sure that they are working together as effectively as possible so that the agent does not later get in trouble with the broker for not following the agent's duties that are expected by the client.

Preparing the Property

The vast majority of properties that are sold today (excluding new home developments) are more than several years old and probably in need of some touch-up work, repairs, or major upgrades or improvements before they should be shown to prospective buyers. Some property owners have lived in their home for the past decade or longer. If so, they may have most of the exact same furniture in the home that they purchased shortly after moving in a few decades ago. Since styles, fashion, and decorative tastes can change significantly over time, the agent might suggest to the owner that they try to modernize the home in order to make it more attractive or appealing to prospective buyers.

An exception to the rule that a home should be cleaned up or modernized if the property is fairly old is for properties being sold “as is” or as somewhat of a “fixer upper” to buyer prospects. For properties in serious need of upgrades, they may attract sophisticated investors or real estate contractors who can make the upgrades at discounted prices since they are doing most of the work themselves.

Some owners will only agree to make minimal interior and exterior upgrades while others might be willing to spend several thousand dollars or more making their home more presentable. If the owner spends \$3,000 to make their home more attractive to buyer prospects and one buyer ends up paying a \$10,000 or more higher price directly as a result of the upgrades, the owner has made a \$7,000 profit on their \$3,000 investment.

Some of the simplest, more common, or even fairly complex interior and exterior improvements that an owner can make to their property may include:

Exterior improvements

1. Lawn and landscaping: The front and back lawns should be mowed or repaired with new types of seeds or sod. It is advisable to buy some colorful flowers that can be planted near the front entrance to the home.

2. Fences: Sometimes, the very first thing that a buyer notices about a home is the front fence that is placed near the lawn. If the little white picket fence or taller redwood fence needs some repairs or touch-up paint, then the owner should take care of it.

3. Pets: Some buyers are either allergic to or afraid of dogs, cats, or other types of pets. During showings, the pets should be secured or taken away from the home on long walks. Any kitty litter boxes should be hidden from sight as well.

4. Paint: If the exterior of the home is in need of fresh paint, the owner might have old cans of paint in their garage that they can use to put on a fresh new coat of paint. The front door, especially, should be touched up because that is probably the first part of the home that the buyer will closely look at upon their entering of the property.

5. Potted plants near the entrance: Owners may wish to consider placing newly purchased potted plants with colorful flowers near the main entry way in both the front and back portions of the home.

6. Patio furniture: For homes with a porch on the front and/or a fairly large backyard, it might be more welcoming and attractive to buyer prospects to see what life can be like while holding an outdoor BBQ or some festive party after seeing nice patio chairs and tables.

Interior improvements

1. Home cleaning: One of the best options for improving the interior of the home is to hire an outside professional cleaning service. Some brokerage firms can get discounted prices for local cleaning companies due to the high volume of work that these offices give them.

2. Paint: Whether it is just minimal touch-up paint or new paint colors throughout the home, it can make a home look brighter, larger, and more welcoming to buyer prospects.

3. Window coverings: Some homes have drapes or blinds that are 30 years old and about to fall to the floor. A more modern window covering selection can go a long way towards improving the interior feeling of a home.

4. Improve natural light: Better window coverings, paint, and other design features can bring in more natural sunlight to a home. A home that is brighter can seem much larger than a dark and cluttered home. Sunlight is known to make people happier while dark and scarier looking rooms can be too depressing for many people.

5. Plumbing: Any water leaks or loud toilet fixtures should be taken care of before showing the property. Water leaks can lead to mold problems that can make residents sick. If any buyers think that there are potential water leaks or mold problems, they might decide to find another home to view.

6. Unpleasant odors: Homes with cats and dogs can have some serious odor problems that the owner doesn't really notice after living there for so long. Owners who smoke cigarettes or cigars can have homes that smell like giant ashtrays or even have stained walls and ceilings from the years of smoking. Any unpleasant odors that are smelled in the home should be addressed as soon as possible and even replaced with more pleasant smells like natural interior flowers or plants, scented sprays, or fresh new

chocolate chip cookie smells that may remind people of their childhood memories.

7. Carpets and other floor options: Most or all of the carpets in the home should be steam cleaned, especially if there are pets in the home. For wood, vinyl, or other composite floors, any nicks or holes should be fixed. Newer doormats or throw rugs can make a nice addition to many of these types of floors.

8. Light fixtures: Light bulbs with wattage that is too low should be replaced with more powerful bulbs that brighten up the room. Older lampshades should be upgraded as well.

9. Closets and cabinets: Many homes have cluttered closets and bedroom and kitchen cabinets that should be cleaned out and better organized partly so that they appear much larger in size to buyer prospects.

10. Crowded furniture: If there is too much furniture in the home, the seller should consider moving some of them to the garage, a separate storage facility, or selling it at the local swap meet or at a garage sale. Homes that appear too cluttered with furniture can look much smaller to people while more open rooms can seem much larger.

11. Garage and basement: Some garages can be stacked from floor to ceiling with boxes of old family photos, school and wedding memorabilia, clothes, furniture, holiday decorations, bicycles, used car parts, and even outdated extra refrigerators. It might be time for a visit to a local charity for a deductible charitable donation or to hold a garage sale that helps to unload many of these items so that buyer prospects can see for themselves how much true space there is for their cars and storage needs.

12: Temperature: Some older homes with wood floors can seem too cold to visitors walking through the property for the first time. For homes that

are colder than most, the listing agent might think about lighting a fire in one or more of the rooms in the home to warm it up (assuming of course there is a fireplace). Other options include lighting candles, opening up the home to more natural sunlight, and turning up the heat if available in the home. A cool summer breeze can make a home seem more livable during the warmer months of the year, so open windows and some doors can be a great choice.

Home staging is a sales strategy in which a property owner hires a professional home staging or design company to partially or fully decorate a home just before the home is placed on the MLS and is available for home showings. A home that is updated with the latest and greatest furnishing designs will generally be more appealing to buyers than a home with furnishings not sold in stores for the past 30 years.



For buyers who are also walking through new model homes at nearby development projects, they are already seeing homes for sale with staged furnishings. When comparing a new model home with an older home for

sale with similar staged furnishings, the differences between the old and new properties may not be that significant. Since older homes usually sell for less money than brand new ones, more buyers may be interested in purchasing the older home that looks brand new on the inside.

One past real estate survey that included thousands of properties sold (staged and unstaged) found that staged home sales sold for at least 5% higher than unstaged properties. The staged home sales also took half as long to sell as unstaged ones. The playing of soft and relaxing music in the background is one of the most popular staging strategies that is used today.

Several home stage organizations exist around the country that can help point the property owner and listing agent in the right direction when seeking a qualified and experienced home stager who works near the subject property. These groups include the International Association of Home Staging Professionals (www.iahsp.com) and the Real Estate Staging Association (www.realestatestagingassociation.com).

Weekly Updates

The agent should keep track of all buyer prospects and agents who have visited the client's home or who have called or emailed about the status of the listing. In some Open Houses, there may be 50 or more parties who walk through the home within a short three-hour time span on a Saturday or Sunday afternoon. It can be encouraging to the seller to see a printed list or spreadsheet of all the parties (principals and agents) who have expressed at least some interest in the property.

Most types of **lockboxes** or **key boxes** on listed properties keep a running list of agents who have used their pass codes to gain access to the key to the home for showings. The listing agent can usually find out the exact names of agents who have shown the listing, and might consider following

up with a phone call to the agents to ask about how the showing went with their clients.

The agent may send weekly packets that include a copy of the MLS entry list for brokers who have shown the property when the owner was away, copies of the most recent newspaper ads being used to promote the home for sale, and a list of attendees at the previous weekend's Open House. The listing agent's continued providing of buyer prospects to the owner also effectively becomes a list of "protected buyers" for the agent should the listing term expire before the home is sold and placed into escrow.

Chapter Six Summary

- Effective ways for agents to find new listing prospects include: 1) tapping into their "sphere of influence"; 2) farming; 3) cold calls (without violating Do Not Call lists); 4) expired listings; 5) FSBOs; and 6) print and online media ads.
- Before meeting with the selling prospect, the agent should complete a detailed analysis of the subject property and the most recent sales and listing comparables that took place, especially within the past six (6) months (also called a **CMA report**).
- A "**chain of title**" search history will show all of the ownership changes and lender or beneficial interests for the property as far back as when the home was built. The agent can request it from a local title insurance company and it can be very helpful when meeting with sellers.
- **Principle of Substitution:** An economic theory that states that a buyer will probably buy the most affordable product, asset, or home

that is available at the same time of purchase if they are almost identical in size, style, or with other shared amenities.

- In addition to the CMA report, the agent might consider providing a cover letter about him or herself, a past resume, background information on the brokerage firm, a list of testimonials from past happy customers, marketing ideas, a seller's checklist to get the property ready for showings, a seller's net sheet based on the proposed list price, and copies of the listing and disclosure forms that will need to be completed.
- All real estate listing agreements are legal contracts. To make up a valid and enforceable contract, there must be competent parties, a lawful object, mutual consent or agreement and some type of consideration.
- The three most common types of listing agreements are as follows:
1) **Exclusive Authorization and Right to Sell** (gives the most protection to listing agents); 2) **Exclusive Agency** (owner can sell by himself directly without paying a commission); and 3) **Open Listing** (a type of unilateral contract in which the seller offers to pay any broker who brings in a willing and able buyer).
- A **Net Listing** agreement is more of a commission split agreement that is based on the seller's desired minimum net profit. The agent will then collect any funds over and above that amount as his or her full commission.

Chapter Six Quiz

1. What is the best source for a chain-of-title search when an agent researches a property prior to offering a listing presentation?
 - A. Public records
 - B. Interview owner
 - C. Title insurance company
 - D. Escrow company

 2. Which item should *not* be included in an agent's listing package presentation?
 - A. CMA report
 - B. Seller's credit report
 - C. Agent's cover letter
 - D. Agent's resume

 3. Another name for a seller's estimated proceeds is a _____.
 - A. Market price
 - B. Seller's net sheet
 - C. Buyer's net sheet
 - D. CMA report

 4. What is the main consideration offered by a listing agent in a listing agreement?
 - A. Commission
 - B. To work as hard as possible
 - C. Good faith
 - D. Accounting

 5. What is the main consideration offered by a seller to his agent in a listing agreement?
 - A. Loyalty
 - B. Confidence
 - C. Promise to pay
 - D. Care
-

6. Which agent is the most likely to get paid by the seller for finding a ready, willing, and able buyer?
- A. Buyer's agent
 - B. Listing agent
 - C. Procuring cause
 - D. Agent with a verbal offer
7. An exclusive agency contract must have a _____.
A. Termination date
B. Specific commission amount
C. Minimum list price
D. Clause allowing the list broker to get paid no matter who sells the property
8. Which standard listing agreement is most preferred by agents?
- A. Open listing
 - B. Exclusive Authorization and Right to Sell
 - C. Exclusive Agency
 - D. Triple Net listing
9. Agents may still be entitled to the full collection of their commission for properties that later sell after their listing term expires under a(n) _____.
A. Open listing
B. Net listing
C. Exclusive Agency
D. Protection clause
10. An open listing is a type of _____.
A. Safety clause
B. Net listing
C. Bilateral contract
D. Unilateral contract

11. Which listing option can generate the highest percentage amount of commission over and above the seller's profit?

- A. Net listing
- B. Open listing
- C. Profit share listing
- D. Commercial listing

12. What is the most likely reason a principal will not renew his or her listing agreement?

- A. Minimal communication between listing agent and owner
- B. Too many brokers nearby
- C. Too many listed properties at the same time
- D. All offers were too low

Answer Key:

1. C	6. C	11. A
2. B	7. A	12. A
3. B	8. B	
4. B	9. D	
5. C	10. D	

CHAPTER 7

LISTINGS - CONTRACTS, SERVICING, AND LAWS

Overview

This chapter will cover a listing contract's required provisions. While the establishment of relationships built upon trust, confidence, and loyalty is perhaps the core foundation of the real estate profession, the next major component is related to completing disclosures and contracts in the most detailed and complete way possible. Should any future legal disputes arise over property sales, the written contracts and disclosure forms will probably be an agent's best defense against any baseless claims made against them or the main things that get the client into trouble if they did not follow agency-law instructions. The creation of contracts, any future modifications, the ongoing servicing of the listings, and the state and federal laws that agents must closely follow will be discussed here in depth.

Listing Requirements

Under California Real Estate Law, the only person who is truly authorized to represent the selling principal is the licensed broker who is in charge of their brokerage office. Even if the listing agreement is presented by a salesperson who works under the main supervising broker's license and the broker never meets the seller in person, the listing is still, technically, legally owned by the broker and shall remain under the broker's name throughout the listing term. A completed listing agreement is a **signed contract**.

Should the salesperson who found the client and signed on the listing agreement later quit the brokerage firm during the listing-agreement

term, the listing still belongs to the original employing broker. A new salesperson would probably be assigned to take over control and management of this listing if the original salesperson leaves the brokerage firm. This is partly why an employing broker should send out a welcome and thank you letter to the seller after they sign the listing agreement because the main agency relationship established is between the seller and the principal broker.



Seller's warranties: The seller makes some warranties, guarantees, or representations in a listing agreement that include:

- It is the seller's right to sell the property on the terms selected for the listing agreement.
- All information provided in the listing agreement is accurate.
- There are no undisclosed encumbrances or liens against the property that may adversely affect the property's value and transferability.

- The seller also provides a “hold harmless” clause and takes full responsibility for any false information he or she provides which then affords some additional layer of protection for the listing broker.

These are just some of the more important sections included in a listing agreement contract:

Listing Price and Terms: The most important section of a listing agreement for many buyers is this one that notes what the listing price is for the property. Any additional terms such as the desired length of the escrow or whether or not the seller might consider carrying some equity as a first or second mortgage will be included here or in other attached addenda.

Compensation to Broker: Buyer’s agents will pay close attention to this section that details how much the seller is willing to pay a buyer’s agent who brings in a ready, willing, and able buyer to close the deal. Most often, the seller will agree to pay somewhere within a 2.5% to 3% commission based on the purchase price to both the buyer’s agent and listing agent (5% to 6% total).

MLS Provision: The majority of listing agreements include some type of clause or provision that instructs the listing agent to place the new listing into the nearby MLS (Multiple Listing Service) within 48 hours of receipt of the signed agreement unless the seller gives different instructions that request that the property not be listed in the MLS. Also in this provision, the seller is notified that any information provided by the seller in the listing agreement is not confidential and that it will be easily accessible online to other agents or members of the MLS.

Deposits: The listing agreement usually provides for some sort of authorization that allows the listing broker to receive and hold a buyer’s earnest money deposit (or “good faith deposit”) on behalf of the seller.

Agency Relationships: The “Agency Relationships” section in the listing agreement states that the listing broker will fully represent the seller. In the same section, there are details about the possibility of a future Dual Agency relationship in which the listing broker may also represent the buyer as long as that dual-agency relationship is fully disclosed. The seller agrees to the fact that the listing agent has the legal right to represent the buyer as well. But this may occur only if the agent does not share confidential information or strategies related to the best ways to gain an unfair advantage during any negotiation process.

Security and Insurance: The listing broker is not responsible for any theft of or damage to personal or real property that is associated with a permitted showing by another agent who has access to the property by way of the lockbox, or any other way that someone gained entry into the property.

Photographs and Internet Advertising: This section of the listing agreement gives the listing broker the right to take interior and exterior photographs of the subject property being listed for sale and allows the agent to share them online or in print media advertisements, unless stated and mutually agreed otherwise.

Key Boxes: This gives the listing broker and other MLS member agents the right to gain access to view and show the property. All other members of the MLS are designated **“cooperating agents”** in listed property transactions. The key box (or “lockbox”) is the most common method used to gain access to listed homes. Some homes are vacant, rented, or have owner occupants there most of the time, so there may be additional instructions in regard to both the best times to show the property and whether the owner requests notification prior to a showing.

Attorney Fees: In regard to any legal dispute arising between the seller and broker that is related to the payment or nonpayment of commission fees, the prevailing party shall be obligated to pay the other party’s reasonable attorney fees and court costs.

Dispute Resolution: The seller and broker have the option in this section to agree or not agree to the selection of a mediation or arbitration forum to resolve any legal or financial differences that might arise out of this transaction. The parties are required to initial this provision to avoid a lengthy and costly courtroom battle over any potential commission disputes or other conflicts. A mediation or arbitration setting usually takes place in a conference room where a retired judge or other legal professional tries to assist. A mediator helps both sides to find a middle ground to resolve the dispute, while an arbitrator listens and then makes the decision as a courtroom judge would.

Signature: The seller's and listing broker's signatures on the listing agreement is what makes it valid and enforceable.

Servicing the Listing

The real estate profession is one that is based upon relationships more so than properties as discussed elsewhere in this course. Just like with a romantic relationship, positive or negative communication skills can make the bonds or connections solid and everlasting or it can cause division between the two main parties involved. For listing agents and their sellers, the number one reason for division, separation, and the end of their agency relationship is usually related to lack of communication from the agent's side to his or her client. An effective communication strategy is for agents to start conversations with a prospective seller while asking if he or she needs assistance selling or buying properties.

Some agents might be quite hesitant to tell their sellers that there have been no calls in the previous week or two to show the property, or that not even one single buyer prospect or agent showed up at the last Open House. Regardless of the discouraging news or updates, the agent should convey to the seller what is going on with the property on a fairly consistent basis. Many sellers want to begin the listing process with the absolute highest price possible in spite of their listing agent begging and

pleading with them to lower it by 5% or 10%.

For listings that are priced too high, it can be beneficial to both the agent and seller to share the information about few parties showing any interest in the property at the current listing price. This way, it will validate the agent's concerns about the property being priced well above current market value and similar sales comparables in the area. If and when the seller realizes they made a serious mistake by pricing it too high, they will hopefully agree to adjust the list price downward with a price modification.

Sellers can feel abandoned by the listing agent if they don't hear from them for periods of time over several weeks. Often, the listing agent might have five or 10 other listings, and the seller may soon believe that the agent is paying more attention to his or her other clients than to the seller. Feeling like a spurned love interest, the seller might start calling other agents in the area who will spend more time on the seller's listing and provide much better weekly communication.

Owners want to know what is happening with their property, regardless of whether the news is good or bad. The irony for many new listings is that it is usually a fairly aggressive agent who first reaches out to the property owner in an attempt to gain their trust, attention, and loyalty while beating out possibly several other agents competing for the same listing. Agents who win the competition to list a specific home for sale should remember to keep showing loyalty and gratitude to their clients by keeping the lines of communication as open as possible.

Homeowners Instructions: As discussed in other sections of this course, agents should strongly encourage their property owners to clean their home, fix up any damaged parts of the home, buy some new colorful indoor and outdoor plants, and consider hiring a professional staging company to make their homes look more like the fancy new model home down the street. Other instructions should include how owners should vacate the property when another agent is showing their home, or at least

situate themselves in an out of the way location somewhere on the property either inside or outside. Owners can stand by to answer any basic questions asked by principals or agents at a showing, but the owners should not be too intrusive and bothersome to any potential buyers viewing their home.

Owners should be instructed to keep a fairly consistent temperature setting in their home that is neither too hot nor too cold during times when the property is being shown or during an Open House. Some agents will politely ask their owners to leave out cold bottles of water, some light snacks, and play some soft music in the background during showings. The intent behind this welcoming strategy is to try to keep prospects and agents in the home for a longer period of time so that they hopefully become more interested in buying the home. Some listing brokers will buy all of the cold bottles of water, sodas, or food snacks (fruit, chips, nuts) and place it in the owner's refrigerator if the owner forgets to buy it.

Agents should let their clients know that **internet advertising is the medium of choice for most buyers**. There aren't very many small classified ad sections in printed newspapers these days. Sellers should understand that many agents will spend more of their advertising or marketing dollars on various forms of internet advertising than in the print media.

Internet advertising can increase the target audience from a few thousand in a small weekly-circulation newspaper to a global audience with millions of possible new viewers. Foreign investors can make up as much as 50% of the buyers in certain zip codes or city neighborhoods in California, so internet advertising can be a much more effective way to promote properties than classified or display ads in local newspapers.

A listing agent should think about driving their new listing client around town during Open Houses on a Saturday or Sunday to show them the competition. Some owners might think they have the most beautiful and valuable home on the block or in the entire community until they see similar-sized homes that are even more appealing and priced to sell below

the owner's current listing price. Walking through multiple Open House tours together may also give the agent and seller some fresh new ideas with respect to how to sell their own property.

Some sellers can get a bit overwhelmed when they first sign the original agency disclosure and listing agreement forms to start the home-selling process. And the paperwork will only intensify and increase if and when a qualified buyer comes forward who is interested in their home. To better prepare the sellers for the flood of new paperwork that may soon be coming in from the buyer's side, the agent should sit down with the seller and go through a sample blank purchase-offer contract line by line so that the seller understands the standard provisions or clauses that are usually filled in by buyers.

Virtual Home Tours: There are many buyers today who live far away from the property that they are planning to purchase. The buyer may be interested in the home for sale as a primary residence, second home, or as a rental property. Some buyers will purchase the properties sight unseen without ever having set foot on the front lawn or inside the home partly because they live a few thousand miles away in another state or country. If so, the buyers are responding more to the photos and videos posted on the internet (e.g., MLS, broker's website, a personalized website for the subject property, or somewhere else).

There are professional video tour companies and software programs that can prepare interior and exterior video tours with or without drones flying 1,000 feet above at prices from about \$100 to \$300 today. The most affordable video tour option is usually the software program where the agent adds in their own photo or video images to the video tour's software system that is later turned into a professional-looking video tour with pleasant music playing in the background. The videos can also be added to YouTube, Vimeo, or to other video or live-stream options to increase the viewership traffic .

Area Canvass Letters or Postcards: One of the best ways to find new listing deals or buyer prospects is to first list a home in the immediate neighborhood. Many neighbors around the listed home will come to know that it is your listing. Neighbors can often be a great source of referrals for buyer prospects when they tell their friends and family how wonderful the area is and that they hope they will move closer to them. If and when the property sells, the listing agent will send out letters or four-color postcards alerting the neighborhood community about how successful the agent was in the sale of the home. In the near future, one or more of those nearby neighbors might remember the name of the agent who sold their friend's home at a nearly record-high price and will then ask the agent to handle their listing as well.

Checking Old Files: Real estate agents might meet thousands of principals and agents during their career. Some agents may speak to hundreds or thousands of people in person or on the phone in just one year. Agents should keep notes or records of past meetings with buyer prospects or agents met at an Open House, on broker caravans, at group seminar meetings, or on private showings. These old notes or records from past meetings with prospects can be matched with the agent's new listing to see if any parties were interested in homes in the same neighborhood or price range.

Listing Modifications

The most likely entry to be modified in a listing agreement is the price for the home. Sometimes, the owner believes that their wonderful home should set the all-time-sales-price record for the neighborhood, while other times, a misinformed agent suggests a starting list price that is well above the most realistic sales comparables in the market during a sluggish economic time period. Occasionally, a home is priced right at the start of the listing agreement, but then several other similar homes with comparable amenities are placed on the MLS for sale at prices lower than the seller's original list price. Once the agent finds

out about a few similar homes that are listed at lower prices, he or she should strongly encourage the owner to drop the price.

MLS members and buyer prospects tend to keep a close watch on the DOM (Days on Market) trends for listed properties. The most prestigious properties with prime locations that are priced to sell during solid economic times may sell within a few days of being listed. If so, the DOM numbers might show 5 or 7 days on market (“pending sale” or “in escrow”). Other older properties in less desirable neighborhoods that are overpriced might show a DOM number that is six months or more (180 DOM). What viewers of the MLS will probably think to themselves is as follows: *“What is wrong with this property?”* or *“This home must be overpriced.”*

The longer a home sits on the MLS, the higher the odds are that the listing agreement term will expire and/or the listing price may be modified downward in an attempt to attract future buyer interest. Some sellers can be completely unrealistic and unwilling to lower their list price.

If there is little-to-no activity on the property and the most recent listing comparables are much lower than the owner’s price, the agent might consider giving the seller somewhat of a final ultimatum or demand: either the seller agrees to lower the price, or the agent offers to return the listing to the seller before the end of the listing term. If the owner agrees, then the agent hands the seller a form that releases the agent of any further obligations or liabilities associated with the property. Some owners will finally realize that their listing agent is right and that the current list price is too high before then finally agreeing with the agent to lower the price before the end of the agency relationship.

The modification of a listing agreement can include other factors besides list price. These changes may include such things as: the owner will consider shorter purchase-offer terms (some owners may want longer escrows because they need to finish up work or school requirements); the

owner may offer some furnishings, light fixtures, or appliances that the seller originally wanted to exclude in the sale; and perhaps the owner may agree to carry some equity in the form of seller financing.

The modification or reduction of the listing price should be created on a modification form or a separate signed and dated letter that includes several key points regarding the reasons why the list price was lowered. A general announcement should be sent out via mail, text, or email by the agent to nearby MLS members and past buyer prospects who showed an interest in the property to alert them of the fact that the price has recently been lowered. Some past buyer prospects may have loved the home after viewing it on a showing tour, but they thought that it was priced too high. With the new price drop, one or more parties may come back with a full price offer at the new lower list price.



Listing Extensions: Listing agents should not wait until the very last minute to present a listing-extension form to the selling principal(s). Most listing agreements are somewhere within the 30, 60, or 90-day range (90 days is the most common). During a boom or bust economic cycle, a home might not sell in the first 90 days for a variety of reasons.

If the owner does not think that the listing agent is working hard or promoting the property enough and communicates poorly with the seller, the owner may not sign a listing extension. This is partly why it is so imperative that the listing agents keep the owner informed of weekly sales activity or buyer interest. The agent should also share the latest listing and sales-price trends so that the owner shall remain loyal to the agent if and when any future listing extensions are requested.

A savvy agent will keep their sellers informed and schedule an appointment a few weeks in advance of the listing's expiration date. At this meeting, the agent will show the owner how much effort he or she has put into promoting the property online and in the print media as well as by way of weekly Open House showings and one or two broker-caravan tours that brought in many agents from the area. The agent can then ask the owner if he or she is interested in having the agent change any of the marketing methods and/or try new approaches. And of course, the agent can ask the owner if he or she has any general questions about the listing process. At that point, the agent should hand the listing extension form for signature for another 30, 60, 90, or 120-plus days, and later send the client a thank you card for continuing to have faith and trust in the agent's abilities.

Short Sale Listings

Over the past 12 to 15 years, there have been millions of properties that were either considered "upside down" (mortgage debt exceeds the home's current market value) or in some stage of foreclosure just in the state of California alone. During the depths of the worst economic cycle in 2008

to 2011, some zip codes had upwards of 40% to 50% of all homes (listed or unlisted) that were designated as upside down or “underwater.”

When the mortgage-payoff amounts exceed the home’s proposed list or sales price, the agent must find ways to persuade the lender to accept payoff amounts that are well below the lender’s original mortgage principal amount, delinquent mortgage payments or back interest, legal costs, and foreclosure filing fees (a/k/a a “short sale”). The highest percentage of home buyers today and over the past twelve years or so purchased homes with anywhere from 0% down (VA loans), to 3% to 3.5% down (FHA loans), and 10% down (for older subprime or Alt-A credit loans), or some combination of conventional financing with seller carrybacks as a second mortgage. As such, the property might have very little built-up equity gains.

With a 30-year mortgage, the first seven (7) years of the loan term does not pay down much principal. In fact, most of the first seven years’ worth of mortgage payments are applied primarily to interest payments as partly covered elsewhere in this course. After the seven-year term, the amortization schedule for the payments begins to speed up and the principal payoff begins to accelerate.

Here is a major problem though for many property owners: The average homeowner today stays in their mortgage seven years or less before they either sell the home to a new buyer and pay off the mortgage debt, or they refinance the property with a new mortgage loan.

Agents need to have a good understanding of how the mortgage process works for property owners so that they can later help their clients get through financially-challenging times when they may be faced with an impending foreclosure action and/or a short-sale listing option. In recent years, more and more lenders are agreeing to accept short-sale offers because the lending institution already has too many distressed and foreclosed properties in its pipeline and it has proven to be less of a financial loss to accept a short-sale offer than to take the property all the

way through to a final trustee's foreclosure auction.

Many highly-leveraged mortgage loans that started out as an 80% LTV (loan-to-value) purchase money loan or even at a much higher loan-to-value range of up to 97% will have both a lender and a mortgage-insurance provider in place, which must both agree to discounting the existing mortgage debt at the time of payoff for a short sale action. Sometimes, the lender wants to foreclose, but the mortgage-insurance premium company that has been collecting monthly premium fees from the borrower for many years does not want the lender to foreclose. Why? Usually it is because the mortgage-insurance company may have to pay the lender a certain percentage of the mortgage-loan amount that was lost by the lender. Some publicly-traded banks do not want to foreclose and acknowledge the fact that they have thousands of non-performing mortgage loans on their financial books that could drive down their company's stock prices.

When both the lender and mortgage insurance companies are in agreement to accept a new short-sale listing price, many agents will use a standardized short-sale system such as one created by *Equator* platform (www.equator.com). Agents can log onto the site, and click on "Initiate Short Sale" (or some other current tab name) to start the automated process. The system will then show the agent the name of the current lender or mortgage loan servicing company and the loan number. In 2015 alone, *Equator* processed well over \$21 billion dollars in transactions, and over \$200 billion in total numbers since the company was founded.

For agents who do not use a faster and more automated short-sale processing system like *Equator*, they should then find the contact information for the lender's designated loss mitigation officer (or some other similar title). After reaching the main contact person in charge of deciding whether or not the lender will accept a short-sale listing amount, the agent should tell them over the phone that he or she will be sending them an updated packet showing the lender how and why the property's price is planned to be listed below the lender's current payoff amount.

The short sale package to the lender to start the process may include:

- An updated CMA (Comparative Market Analysis) report that shows all of the most recent sales comparables (and listing comparables if there are not enough nearby sales) over the past three or six months.
- A hardship letter from the borrower that might detail how they lost their job or dealt with a serious health issue that was financially devastating to their family.
- A financial statement that lists the borrower's most current assets and liabilities (their debts will usually exceed their assets or net worth).
- Copies of the borrower's most recent bank statements (checking and savings).
- Copies of the borrower's last few months' worth of credit-card statements (high credit-card balances might convey to the lender that the borrower is on the verge of filing for bankruptcy protection that could delay the lender from completing any foreclosure filings for quite a long time).
- A copy of the lender's proposed net sheet based upon the offered list price.
- A copy of the signed listing agreement along with some marketing material, if available.

Even after the lender agrees to the original short-sale list price, the agent should consider sending an updated copy of many of the same documents included in the short-sale package above as a way to show the lender how financially destitute the borrower is at present. Often, multiple lender departments will review a broker's short sale package at the start of the listing period and after receiving an offer from an interested buyer. The agent will also send to the lender's loss-mitigation department a copy of the buyer's prequalification mortgage letter, a copy of the buyer's earnest

money deposit check written to tie up the deal, a copy of one of the buyer's bank statements to show sufficient funds to close if it's an all-cash offer, and a copy of the buyer's signed purchase offer agreement.

Some buyers may even include the words "*buyer will pay all closing costs*" in the contract as a strategy to get the lender to quickly agree to their short-sale offer. In some short sale situations when the property is priced at a very fair price, there may be multiple short-sale bid offers. If so, some buyers might make offers much higher than the list price so that they beat out any competing offers.

Transfer Disclosure Statement

A Transfer Disclosure Statement (also known as a TDS form) is required by law to be completed and signed by both the seller and listing broker. It is specifically Section 1102 of the California Civil Code that requires that every single residential seller in the state complete the TDS form before selling their property. The disclosure laws apply to all single-family homes (listed with agents and FSBs), condominiums, townhomes, cooperative units ("co-ops"), duplexes (two units), triplexes (three units), fourplexes (four units), and attached mobile or manufactured homes.

During the contract contingency time period when buyers will complete their inspections and other due diligence, the TDS form helps buyers better understand the current condition of the property being sold to them and which items are included or excluded from the sale. In any future legal disputes over property defects later discovered by the new owner, the main piece of evidence presented is likely to be a copy of the three-page TDS document. As such, it is very important that both the seller and listing broker be honest and forthright when making disclosures about the condition of the property.

It is suggested that the seller first complete this form in their own handwriting, initial, and sign it. An agent is not supposed to complete the

main portion of this TDS form for the client, or they could get into serious trouble. By doing so, the agent is taking risks -- potential financial, legal, and licensure risks.

A TDS is *not* usually required for the sale of new homes in a residential-development community where a public report has already been completed and delivered, for a sale that is pursuant to a court order such as one related to a deficiency-judgment sale for recorded liens, or for a probate-court sale associated with the passing of the property owner or their designated heirs or beneficiaries. There are no TDS form requirements for a transfer between married or divorcing spouses, or for foreclosure sales transactions.

The main sections in the TDS form include:

Part I. Coordination With Other Disclosure Forms

Part II. Seller's Information

Part III. Agent's Inspection Information

Part IV. Agent's Inspection Disclosure

Part V. Buyer(s) And Seller(s) May Wish To Obtain Professional Advice And/Or Inspections Of The Property And To Provide For Appropriate Provisions In A Contract Between Buyer And Seller(s) With Respect To Any Advice/Inspections/Defect

The **Seller's Information (Part II)** section takes up the largest portion of the TDS form. The first part of this section is a series of checklist boxes that are related to the amenities found in the property and what will be included in the property's sale such as appliances, heating and air conditioning systems, and smoke detectors. The second portion of this section has questions for the seller about whether he or she has any knowledge of potential problems with major areas of the property such as

the foundation, the framing, plumbing, and electrical systems. The third part of the TDS form has 16 questions with “Yes” or “No” boxes that the seller will check that concern issues such as any drainage, environmental, zoning, private restrictions, and pending lawsuits that could potentially negatively impact the property.

Most of the third and final page for the TDS form is for the listing agent to fill out, check, initial, and sign. Before signing this section of the disclosure form, the agent is required to complete a visual inspection of the subject property to ensure that there are not any serious property defects that the agent did not notice before signing the TDS form. For agents who need more room to list all of the property defects they saw when personally inspecting the property, they may complete a separate three-page form called an **Agent Visual Inspection Disclosure** form, and/or they may add addendum pages.

Even if the agent disagrees with disclosed statements made by the seller in his or her completed section of the TDS form, the agent must honestly list his or her perceptions and concerns about the property or be at personal risk of being sued by the buyer and the buyer’s agent at a later date. In situations where the seller refuses to be honest about disclosing property defects, the listing agent would be very wise to try to cancel and rescind the listing agreement due to the potential civil, criminal, and license penalties that the agent could face if the deal turns sour in the near term.

In accordance with California law, single-family homes are required to have a working and fully functional smoke detector at the time of sale. Any water heaters on the property must be braced, anchored, or strapped to prevent damage from an earthquake or extreme weather events. The seller is required to make a statement confirming that the home being sold complies with those guidelines.

In the fifth and final section of the TDS form, the buyer and the buyer’s agent are strongly encouraged to hire their own third-party professional

inspectors to check the property for any defects during their contingency time period that might last anywhere from 10 to 30 or more, depending upon the mutually agreed-upon terms in the purchase offer. Agents and sellers must clearly outline in their contracts how much real time the buyer has to complete their third-party report inspections (appraisal, home inspector, termite and pest control, environmental hazards, etc.).

TDS Timing & Delivery

The seller or listing broker must give a copy of the completed TDS form to the buyer “as soon as practicable” after the purchase contract has been signed, mutually accepted, and well before the title to the property transfers from the seller to the buyer. Some buyers might waive their right to be provided with a copy of a completed TDS in certain situations like a “fixer-upper” deal that has multiple offers from “fix-and-flip” investors or contractors.

After the completed TDS form has been received, the buyer then has three (3) business days after personal delivery of the document, or up to five business days after the TDS form has been deposited in the mail, to either accept the disclosure or rescind the purchase offer and back out of the deal. Or, the buyer might ask for more time to walk through the property again, or hire a third-party professional inspector to fully inspect the property if both parties mutually agree.

Should the buyer emphatically decide to back out of the deal after receiving a very concerning TDS form that outlined potentially costly damage to the property being sold that the buyer had not expected or could not afford, the buyer must notify the seller of his intent to back out of the deal in writing. The seller will then be forced to fully refund the buyer’s entire earnest money deposit.

In transactions where the buyer has accepted the original TDS prior to other new problems arising on the property, the seller should then amend

the TDS form and make full disclosure about the most recent problems found on the property. Or, the seller has the option to fix the problem before transferring ownership interests and title to the new buyer. For any amended TDS forms during the escrow process, the buyer has another three (3) business days if delivered in person, or five (5) days if mailed, to accept or reject the disclosure before they rescind the purchase contract.

After the deal has closed escrow and title has been conveyed to the buyer, the new homeowner does not have the right to rescind the deal. At this point, it can become a legal dispute in court, in mediation, or in arbitration if the seller does not agree to fix whatever the undisclosed problem is.

Any home improvements made to the property such as a recent installation of a swimming pool, new electrical, plumbing, or lighting systems should be noted in the TDS form. Maintenance of the property, such as recent carpet or drape cleaning does not need to be included in the disclosures.

Environmental Hazards

Disclosures made by sellers and listing brokers about the property must also include some references to environmental factors that may directly or indirectly impact the property. The seller and broker are required to hand over to buyers a copy of certain pamphlets that explain some of these risks such as the publication entitled *Environmental Hazards: A Guide for Homeowners, Buyers, Landlords, and Tenants*.

For properties that may be exposed to greater environmental risks such as fires, floods, and earthquakes, the seller and listing agent must complete a **Natural Hazard Disclosure Statement**. Some of the most significant natural hazard risks for properties are those located near the base of a nearby mountain or hill (floods, mudslides), close to a river or

another body of water (floods), close to forests (fires), or in seismic hazard zone regions (earthquakes).



Sellers and agents might have to hire an environmental specialist to sort through old records for possible property locations in flood, earthquake, or fire zones before completing the Natural Hazard Disclosure Statement. There are regions in the state that have 100-year flood zone designations as determined by FEMA (Federal Emergency Management Agency - www.fema.gov) where the odds of a flood in a certain region as happening 1 in 100 years (or 1% per year) is calculated based upon the review of past historical records.

Buyers have the same rescission rights with completed hazard-disclosure forms as they do with a TDS. For residential properties (one-to-four units) built before 1960, the listing agent is required to give the buyer a copy of

a pamphlet published by the California Seismic Safety Commission that is entitled *The Homeowner's Guide to Earthquake Safety*. There is a disclosure form called the **Residential Earthquake Hazards Report** that the seller should complete and hand over to the buyer when giving them the earthquake pamphlet. In this hazards report, the seller will confirm whether they completed any seismic retrofitting to reduce future earthquake risks and if the property is located in an earthquake fault zone (or seismic hazard zone) region.

Lead-Based Paint Disclosure

Federal law requires that any sale or lease transaction for a home built before 1978 must include the seller's or landlord's full disclosure about any past lead-based paint that was used in the home. Many homes built prior to 1978 did have lead-based paint and all homes built after this year no longer contained lead in the paint; this is why 1978 is the cutoff for the full disclosure about lead-based paint.

The lead-based paint disclosure requirements for the seller or landlord are to:

- Disclose the location of any lead-based paint that was used in the home.
- Provide a copy of any past home inspections that noted the existence of lead-based paint.
- Provide the buyer with a copy of the lead-based paint pamphlet that was prepared by the Environmental Protection Agency (EPA).
- Allow buyers up to 10 days to complete their own personal or professional inspection of the property.

Water, Mold, and Pest Damage Disclosures

Water Risks

Few environmental factors cause more damage to a home than water. The water damage may originate from leaky plumbing, roofs, or basement dwellings. Over time, the water may begin to rot the wood frames or portions of the foundation that are not made of cement. This damage will eventually weaken the building structure.

Sellers, brokers, and buyers should all look for warning signs related to potential water damage:

- Water stains on floors, walls, or ceilings
- A musty or mildew smell
- Loose or warped wood floors
- Cracked, warped, or chipped tile, vinyl, or composite floors
- Holes in the roof

Mold Risks

Water can lead to mold, mycotoxin, and other kinds of fungal risks that can create dangerous levels of indoor pollution for the home's occupants. Mold is made up of very tiny and microscopic living organisms that can be hard to see with the naked eye. A fungus can be both mold and yeast. A fungus is also the principal decomposer in ecological systems where they like to exist in water-rich environments found in sand, dirt, plants, and dark, humid walls, ceilings, attics, and basements, especially.



Mold or fungi exposure inside of a home can trigger severe inflammation, allergies, asthma, and numerous types of autoimmune disease-like responses that may include these symptoms:

1. Fatigue and weakness
2. Headaches or migraines
3. Light sensitivity
4. Poor memory
5. Brain fog
6. Joint pain, muscle cramps, and overall body pain
7. Skin rashes that might be itchy
8. Breathing problems
9. Red eyes
10. Vision challenges
11. Stomach pain
12. Metallic taste in mouth
13. Vertigo or dizzy spells

14. Clogged sinuses
15. Mood swings
16. Depression
17. Personality changes

The Environmental Protection Agency (EPA) is one of the main federal agencies that works to assist owners with any mold risk concerns in their homes. The EPA provides a free pamphlet that sellers should also consider giving to buyers that is entitled *A Brief Guide to Mold, Moisture, and Your Home*. The EPA information booklet starts out with these words:

“Why is mold growing in my home? *Molds are part of the natural environment. Outdoors, molds play a part in nature by breaking down dead organic matter such as fallen leaves and dead trees, but indoors, mold growth should be avoided. Molds reproduce by means of tiny spores; the spores are invisible to the naked eye and float through outdoor and indoor air. Mold may begin growing indoors when mold spores land on surfaces that are wet. There are many types of mold, and none of them will grow without water or moisture.*

Can mold cause health problems? *Molds are usually not a problem indoors, unless mold spores land on a wet or damp spot and begin growing. Molds have the potential to cause health problems. Molds produce allergens (substances that can cause allergic reactions), irritants, and in some cases, potentially toxic substances (mycotoxins). Inhaling or touching mold or mold spores may cause allergic reactions in sensitive individuals. Allergic responses include hay fever-type symptoms, such as sneezing, runny nose, red eyes, and skin rash (dermatitis). Allergic reactions to mold are common. They can be immediate or delayed. Molds can also cause asthma attacks in people with asthma who are allergic to mold....”*

Source: <https://www.epa.gov/sites/production/files/2016-10/documents/moldguide12.pdf>

Over 50% of Americans today live in towns, cities, or counties that are adjacent to large bodies of water such as oceans, lakes, rivers, or wetland regions. Since California is adjacent to the Pacific Ocean and has many small to large lakes, rivers, streams, and wetland regions, the risk for mold in California is much higher than most agents probably understand. Mold can also grow in cold regions in the mountains as well as in the hottest desert regions, but more so where it is damp.

Moisture, or the access to water, is the most important factor that can cause mold to multiply quickly. Some molds can grow in less than 24 hours if enough moisture is added to active spores on the property. Scientists and environmental specialists have made the claim that there are anywhere from 100,000 to 400,000 types of fungi on the planet today. Out of these hundreds of thousands of fungi types, there may be upwards of 1,000 mold types living, growing, and multiplying in homes across America.

Molds can be broken down into **three main classifications**:

- * **allergenic** molds that cause allergies and asthma;
- * **pathogenic** molds that can create flu or pneumonia-like reactions along with breathing problems and serious lung disease if untreated; and
- * **toxigenic** molds that are the most dangerous and toxic, and can cause severe autoimmune disease-like symptoms, brain damage, and cancer.

Five of the most common types of indoor mold include: 1) Alternaria; 2) Aspergillus; 3) Cladosporium; 4) Penicillium; and 5) Stachybotrys chartarum (a very toxic type of “black mold”).

Owners who find the most toxic types of mold problems in their home might end up with life-threatening illnesses that shorten their lives. If the mold is so toxic, the entire home may need to be bulldozed and completely torn down. In a situation like that, the buyer of the property,

or his or her surviving heirs, may later file a multi-million dollar lawsuit against the former owner (or seller) and the listing broker for not fully disclosing the potential risks associated with mold on the property. This is why it is so critically important to fully disclose any known property defect issues or potential issues that can later harm the occupant and the property itself.

Termites and Other Pests

Some 60% to 80% of all homes located in certain areas of California may contain one or more types of wood-eating pests. Most homes were built with wood frames, beams, and even a mixture of wood and cement for many foundations. For some reason, termites seem to prefer living in homes near coastal waters more so than out in the middle of the desert. Yet, termites and other wood-eating pests can be found in many parts of the state.



It has been said in past years that if all termites on Earth were placed on one giant scale, the combined weight would exceed the weight of all humans combined by a factor of 10 to 1. Or, the weight of all termites combined would be 1,000% heavier than all living human beings combined. With that thought in mind, agents might realize the damage that these pesky little creatures can do to properties across the state.

Chapter Seven Summary

- Under California Real Estate Law, the only person authorized to represent the selling principal is the licensed broker who is in charge of the brokerage office. This is true whether or not the main broker ever meets the principal in person.
- A completed listing agreement is a **signed contract**. The seller will make some warranties, guarantees, or representations in the listing agreement that can make the listing agent and supervising broker financially and legally liable should the seller not be truthful and forthright.
- The buyer's and seller's agents in a listing transaction will usually be paid a **commission** that is based on the selling price. The payment of 3% commissions to each side is typical. However, all commissions are fully negotiable.
- Agents might wish to encourage their owners to clean and fix up their home, buy colorful indoor and outdoor plants, and consider hiring a professional staging company to make the listed home more presentable for showings.
- Weekly open houses, broker caravans, virtual video tours posted online, and mailed postcards to neighbors in the nearby community are great ways to let people know about an agent's new listing.
- **Short Sale listings:** Agents will usually prepare short sale listing packets to present to lenders and mortgage loan servicing companies prior to lender approvals for listing prices that are less than the current mortgage balance. The packets may include: 1) financial hardship letters from the homeowners; 2) copies of the owner's most recent bank statements; 3) CMA reports with the

latest sale and list price trends; 4) marketing strategy ideas; and 5) a copy of the listing agreement.

- A **Transfer Disclosure Statement** (also known as a TDS form) is required by law to be completed and signed by both the seller and listing broker. The **Seller's Information (Part II)** section represents the largest portion of the TDS. The listing agent must also complete their own section of the TDS from their own visual inspection of the subject property even if their viewpoint differs from the owner's. In a legal dispute involving a buyer and seller after the close of escrow, the completed TDS form may be the main item presented as evidence.
- Environmental damage risk potential must be fully disclosed to buyers for matters related to lead-based paint, mold, floods, and earthquake hazards in one or more separate disclosure forms. Termites, and other wood-eating pests must be fully disclosed and sellers should consider suggesting that the buyer hire his own third party inspector.

Chapter Seven Quiz

1. A completed listing agreement is a(n) _____.
 - A. Unilateral contract
 - B. Signed contract
 - C. Verbal contract
 - D. Open contract
 2. What does a seller give the buyer in a listing agreement?
 - A. Warranties
 - B. Guarantees
 - C. Representations
 - D. All of the above
-

3. Most listing agreements should be placed with the MLS within _____.
A. 24 hours
B. 48 hours
C. 3 calendar days
D. 3 business days
4. All members of the MLS are designated as what in a listing agreement?
A. Competing agents
B. Subagents
C. Cooperating agents
D. Participating agents
5. How do most buyers find properties?
A. Internet advertising
B. MLS
C. Print advertising
D. Through brokers
6. A listed home with a designation that notes "200 DOM" is one that is probably _____.
A. Priced to sell
B. Priced too low
C. Priced too high
D. Listed during a seller's market
7. When should a listing agent ask for an extension?
A. At the signing of the original listing agreement
B. A few weeks before the listing expires
C. A day before the listing expires
D. On the day that the listing expires

8. An online standardized short sale system is called ____.
- A. MLS
 - B. NAR Short Sale Central
 - C. Equator
 - D. Foreclosure Trustee Services
9. Which is the first section in the Transfer Disclosure Statement (TDS) form?
- A. Coordination With Other Disclosure Forms
 - B. Agent's Inspection Information
 - C. Seller's Information
 - D. Agent's Inspection Disclosure
10. How long does a buyer have to respond to a TDS that was personally delivered?
- A. 1 day
 - B. 3 business days
 - C. 3 calendar days
 - D. 7 calendar days
11. A lead-based paint disclosure form must be provided to all buyer applicants for homes built prior to ____.
- A. 1961
 - B. 1967
 - C. 1973
 - D. 1978
12. Which type of mold is considered the most dangerous for humans to be exposed to in a home?
- A. Toxigenic
 - B. Allergenic
 - C. Pathogenic
 - D. Aspergillus

Answer Key:

1. B	6. C	11. D
2. D	7. B	12. A
3. B	8. C	
4. C	9. A	
5. A	10. B	

CHAPTER 8

Showings, Preparing Offers, and Negotiating

Overview

Real estate agents will usually meet and speak to hundreds or thousands of prospects or clients in their career. The more prospects they speak to each week, the better the chances that the agent will convert those leads into closed sales. This chapter will cover the various steps involved in the buyer's brokerage side of the business which includes the first contact, setting up appointments, minimizing safety risks, the creation of tour presentation packets, offers, counteroffers, the handling of good faith deposits, and successfully closing deals.

Customer Inquiries

Many agents will have first contact with a prospect by way of a phone call, text, or email. Some client prospects may want to be fairly anonymous when they reach out to an agent with questions about a specific property or service option. A fair number of consumers will “shop around” for agent services just like they would do when trying to find the lowest price for the latest smartphone model they are interested in purchasing. The agent should try to schedule the initial meeting at the agent's office instead of at other locations, if possible.

At the start of an agent's career, the new licensee may not have any listings to advertise, so they must seek out new clients for purchase or lease transactions. The agent has several ways to find new clients besides tapping into their “sphere of influence” contacts (friends, family, past co-workers, schoolmates, etc.) such as the following options:

- Hold an Open House for another agent's listing
- Ask for "floor time" hours at the office as a way to accept incoming calls from interested prospects
- Attend meetings or parties at large apartment complexes to meet potential new home buyers

Where is the best place to meet other agents and potential clients?

While unlicensed assistants can handle some questions from clients on the phone or in person, they cannot answer specific questions about real estate contracts, the price and terms relating to the properties, mortgage applications, the costs associated with the transaction, or other issues for which one needs a license. As such, the experienced agents with multiple listings may be eager to ask new licensees to handle their open houses, return phone calls from prospects, and set up appointments with prospects prior to showing them around town.

Most open houses are held on weekends in the afternoon. Specifically, Saturday and Sunday between 12pm and 3pm (or 4pm) tends to be the most popular time selected for holding an open house. This makes sense because there will likely be more buyer prospects out there looking at properties because they are not at work.

Unless the experienced agent with 10 or 20 listings can clone himself, he will need assistance from other agents to set up the open houses. Agents may need to place multiple signs around the property within a few-block radius so that the property is easier to find, handle phone calls during the week about the upcoming open house schedules, and be there at the property during the open house hours to meet and greet the principals or other agents who show up to view the property. Some agents will serve cool bottles of water, cheese and crackers, fruit slices, or cookies to open house attendees partly as a way to keep them touring the property as long as possible and to make those prospects feel welcome.



One of the most effective ways to get a prospect's name and contact information is to have a sign-in sheet or guest book that is placed on a table near the front entrance. It may be beneficial to place the guest book near the free food and drinks display so that prospects are more likely to grab some food and sign the book at the same time.

New agents who handle incoming calls about another agent's listed property or who meet prospects at these open houses should keep a log or list of the callers or open house visitors that includes as many of the following details as possible:

- The prospect's full name
- The best contact numbers and address
- The property price range that interests them
- Their time needs and constraints for moving to a new property

- Did the prospect get fully qualified with a mortgage broker or bank?
If so, what price range did they qualify for and how much money do they have for a down payment?

Agents need to remember that the vast majority of people who walk through an open house will not buy it. Some open houses may have 20 or more prospects who walk through the property during a relatively short three or four hour time window on a Saturday or Sunday. Some properties may take several months or longer to sell during both good and bad economic time periods.

The new agent may be holding an open house at one or more properties at least two days per week during the weekend for several consecutive months. If the agent gets the names and contact information for an average of 10 people at each open house over a period of four months (16 weekends) while working both Saturday and Sunday, the agent can build a prospect list with at least 320 names (20 prospects per weekend x 16 weekends).

The agent should follow up with these prospects within a few days of the open house by calling them and sending them thank you cards for visiting the open house. Agents can also hold open houses during the week in the late afternoons to attract new buyer prospects. Because there are fewer open houses held on weekday afternoons, the agent will likely have much less competition from other nearby open houses. Friday afternoon, especially, between 3pm and 6pm (or 7pm) can be a great day and time to hold an open house because some people have already begun celebrating the upcoming weekend early.

Floor time: Most small and large brokerage offices will offer their agents “floor time” to handle incoming calls or meet with prospects who walk in off the street. The floor-time options might consist of a two to five-hour time span each day of the week that agents can sign up for on a clipboard or a bulletin board placed somewhere in the office.

Depending upon the size of the brokerage firm and whether it is a nationally recognized franchise office name, there may be calls from various states and even countries around the world about properties located near the brokerage firm's location. Some brokerage franchises will refer clients to affiliate offices in other regions or states, so there can be some exceptional referrals that are called into offices during an agent's floor time experience.

A larger brokerage office might pay to run their own ads each week that may generate several calls each day. Agents who sit up front at the desk near the main entrance or who accept floor time calls from their own desk or their cell phone outside of the office should be familiar with the properties being advertised each week. An agent should make copies of all properties being advertised so that they are able to answer at least some basic questions about each property. In addition, the agent should create a list of "backup properties" that are available for sale that are similar to the listing properties being advertised as a way for the agent to show the customers multiple properties in case the advertised property sells to another party.

A **corporate relocation** (or "business relocation") can be an incredible opportunity for an individual agent or an entire brokerage firm. In scenarios like the "**relo**" transfer, a large division or the main corporate headquarters plans to move from one county or state to an area near the brokerage office that they contact for assistance. There might be 100 or more well-paid employees and their corporate executive employers who will need homes to buy or apartments to lease within the next several months.

For higher paying companies, their employees might earn \$100,000 or more in household income that will qualify them to buy homes in more expensive price ranges over \$500,000. The top executives might qualify for homes priced above \$1 million or more. For brokerage offices that receive calls from a company's Human Resources department or from a Corporate Relocation specialist who is in charge of the coordination of the

job transfers, this can be a wonderful opportunity for the agent who is fortunate enough to pick up the phone during floor time.

Apartment building meetings or parties: In California, a high percentage of rents paid for apartment units within 50 or even 100 miles of the coastline are higher than most people across the nation pay for their average monthly mortgage payments. It is not uncommon to see some apartment units being leased for between \$5 and \$10 per square foot. As the push for more high-density apartment unit construction continues forward in the state, the average apartment-unit sizes are declining while the price per square foot rises. Some smaller high-density apartment units in downtown metropolitan regions or prime coastal or beach cities are somewhere within the 300 to 600 square-foot range and lease for \$2,500 to \$3,000 or more per month.

Some of the largest apartment complexes can have hundreds or even thousands of units scattered across multiple building structures in places like Newport Beach and Irvine. There may be several different pools and clubhouses with BBQs and tables and chairs, where weekly or monthly parties are either organized by the on-site management company or by local residents. New agents should think about attending these parties with their business cards and flyers to find new buyer prospects, many of whom are probably growing frustrated throwing all their rent money away when they can probably find a new home mortgage option that is more affordable for a property with much more living space and the potential to build up some equity.

Scheduling Appointments

The main goal for any agent who takes an incoming call from a customer who is showing some interest in buying or leasing a property in the near term is to “close the call” by persuading the caller to meet with the agent in person to further discuss their needs and interests. Instead of using vague words like “if,” the agent should act as if they will definitely meet

and use more empowering words such as “when” as it relates to their impending meeting date.

Some callers to offices may be initially hesitant to even give the agent their name let alone their phone number or email address. These callers may just ask for the property address of the subject property being listed for sale that piqued their interest after seeing the display ad in the newspaper or online so that the customer could just drive by the property. For situations like these, the agent could reply as follows:

“I will send you some interior and backyard photos of the property so that you can see the rest of the home that you cannot see just by driving by it. The owners did a complete remodel, and the kitchen, bathroom, and new fireplace are as nice as I’ve ever seen. What is your email address?”

Should the customer become more interested in the interior and backyard photos, then the agent will now at least have the customer’s email address for some type of ongoing communication with the prospect. While showing clients a property, the agent should anticipate and pay attention to any objections that the client might voice about the home, such as a small kitchen, and try to overcome those objections by emphasizing other positive features of the home.

Cell Phones and Caller ID: In the 21st century, most agents and principals seem to prefer using their cell phone rather than a landline when placing calls. What is nice about cell phones is they will usually capture the caller’s phone number even if they do not leave a message. The agent then has the option to call them back with property details or text them photographs or financial links. Sometimes, the agent may have to try to reach the customer several times before the customer sees enough solid information that inspires them to text, email, or call the agent back.



Avoiding Do Not Call or Spam lists: Another positive for agents who communicate with clients with spoken, typed, or texted words is that the agents may have fewer concerns about violating any Do Not Call or Spam laws even if the customer has placed their name on one or more of these national lists. The agent was contacted first by the customer, so it is more of a “warm lead” than a “cold call.”. Once the customer has provided the agent with at least one way to contact them (phone number, email, or mailing address), he or she has given the agent permission to connect.

If and when the customer later politely asks the agent to stop contacting them, then the agent should comply with their requests or face possible future fines or sanctions that are related to the Do Not Call or Spam laws.

Important Point: Due to the extremely high financial penalties associated with calling someone on the Do Not Call list, it is highly

advisable that the agent ask for written permission to contact prospects who were first met at an open house.

The First Appointment

The absolute best place to meet a new customer in person is at the brokerage office. This way, the agent can show the client how impressive their office is while serving them coffee, bottled water, and tasty snacks in the main conference room. Also, the agent has more access to the MLS and other online tools that can provide the latest real-time listing and sales comparable options.

Most new agents will feel more confident and at ease if they meet their client on their own “turf” at their office instead of at the client’s home, at a property, or at a coffee shop somewhere. This is especially true if the agent is a woman who might be concerned about safety issues when meeting a client for the first time in person. Some brand new agents might ask their employing broker or another experienced agent to sit in the meeting with them while speaking with the new client(s). If the new agent does not know the answer to a question asked by the customer, the broker should be able to quickly answer it.

The first few minutes when two or more people meet is usually the most important time to establish rapport, trust, and confidence in one another. The agent must be cordial, attentive, cheerful, and maintain steady eye contact with the client so that the client feels safe, appreciated, and respected when meeting at the agent’s office. If the agent knows very little about the market trends or properties listed in the area of interest for the customer, the new licensee can focus more on being likeable and attentive while the broker or other experienced agent in the room can answer the most challenging questions.

Henry Ford, the primary founder of the Ford Motor Company, noticed in the early years of building his company that his salespersons were not

very good at talking with families. He later developed a sales strategy that combined family and business communication skills and techniques that could benefit both home and work life. His F-O-R-D sales strategy was designed with the intent to especially make the initial meeting with someone as comfortable as possible for all parties involved.

In order to make a person feel comfortable within the first few minutes of meeting them, both sides should focus on any common or shared interests that they can talk about. These topics can include growing up in the same city or county, their life as a parent and their children's school activities, sports interests, hobbies, and their future dreams or goals in life.

F - Family: Are they single, married, or have any children? If not, do they have any siblings, parents, or cousins who live near them? If they have children, are they seeking homes that are relatively close to a certain school or at least in a particular school district that interests them?

O - Occupation: Ask the client if they work from home or drive to the office almost every day. If the customer has an almost daily commute, then ask them what is their maximum mileage distance that he or she will consider between their new home and office. Ask if taking public transportation is important to them. The agent can then politely ask about the customer's desired minimum and maximum purchase-price range based upon their qualifying household income and what sort of a cash down payment they are able to put down on a new home. Any answers provided to the distance, price, and income questions can help the agent zero in on a specific neighborhood or city sector. The agent should then ask the customers about getting qualified for one or more mortgage loan options.

R - Recreation: The agent should ask the new customers about their favorite hobbies and sports activities. If the customers say that they love to play golf, then the agent can look for homes located in golf course

communities.

D- Dreams: The agent might consider asking their customers to close their eyes and imagine their ideal dream home. Then, the agent should ask them about their future plans when their children are older, or their goals and aspirations as it relates to their retirement years. If they imagine a home with a front porch and a rocking chair on it and/or a home within one block of their favorite beach, then the agent should scramble to find a home with a front porch near the beach.



Safety Issues

Personal safety issues have become a bigger topic in recent years after more and more agents have been attacked, robbed, raped, or murdered in vacant properties that the agent was showing. One study from a few years ago showed that almost 33% of all real estate agent victims were men, so it is not just a gender issue related only to women.

One of the biggest scams out there today is when someone calls an agent, gives the agent a false name while using a temporary prepaid cell phone that they purchased at a local convenience store or elsewhere for more anonymity, says that they are all-cash buyers who need to close escrow in the next few days or weeks for higher priced properties near \$1 million or more, and must meet as soon as possible at some expensive, vacant listed property that might be located in a secluded area with very few neighbors nearby. Because the commission possibility might be \$30,000 or more (3% buyer's brokerage commission for a \$1 million dollar home sale), the agent may drop almost everything, focus on meeting the potential buyer at the desired property, and not even think about the serious safety risks.

The agent then shows up to meet the typically well-dressed "client" in front of the home. Shortly after they walk into the vacant property together, the person may rob, rape, and/or murder the real estate agent. Unfortunately, past love interests like former boyfriends, girlfriends, husbands, or wives have used strategies like these to get back at their ex-lover for ending the relationship with them. Past business associates who felt wronged by the agent may try to do the same thing, partly because they know what motivates the agent and their most common business strategies.

To minimize safety risks, agents should consider the following appointment or showing strategies:

- Write down the customer's name and attempt to do an online search to learn more details about them.
- Write down the property address (or addresses).
- Bring a second person with them to the appointment.
- Leave a secret code word or phrase with their assistant or office secretary that they will use if/when they feel threatened, so the "client" standing near them does not know they are giving a warning signal. An example might include "can you find the orange file for me?" Since the agent does not have an actual orange file in their cabinet, it is an alert to call the police because the agent is facing potential imminent danger.



Showings

Shortly after the initial meeting in person, the agent should work as effectively as possible to build a list of properties that may meet the client's interests and needs. If the client wants at least a 3 bedroom, 2 bath home that is at least 2,000 square feet in size within a one mile radius of a desired elementary school for their children, then that is the main region that the agent will focus on to find available listings. After listening to the buyer's needs and interest in one or more properties, the agent should learn the important details about the client and the properties that interest him or her, while not showing any concern about possibly failing to make a sale; an agent's financial constraints should not come through in his or her communications with clients..

Agents should also make a list of "pending sales" (or properties sold and currently in escrow) just in case these properties later fall out of escrow and become available as backup options. The agent should also know the school boundaries so that the home purchased qualifies the children to attend their desired school.

The agent should be aware of the retail shopping, restaurants, houses of worship, and recreational activity options that surround the properties that are being shown should the clients have any questions. The agent might inquire about the various public transportation options such as trains, airports, and bus terminals that can be easily accessed by local residents. Another option for the agent is to contact the local Chamber of Commerce for printed lists or brochures about the town or city's libraries, school districts, community events, and the latest demographic trends. The more information an agent knows about a specific area, the easier it will be for the agent to sell the neighborhood to the customer.

Property Comparison lists: The agent might narrow down the list of the best potential properties to show the client on the very first showing to just two or three properties that are located on Main Street, Vermont Street, and Sunset Place. Most brokerage offices have software systems

that will compare and contrast one subject property with a few other properties on an 8.5 x 11 letter-sized sheet of paper. Each of the three main properties will have their own sheets that will include property comparisons (photos, bedroom, bath, and square footage numbers, etc.) to two or three other unrelated properties. This way, the client can see the potential positives and negatives between the property being shown in person today and other properties that the agent may not show them.



Important Point: The agent must show the clients the types of properties that meet the client's needs and interests more so than the agent's. A client who is shown properties that do not meet the stated needs and interests of the client will probably show the client that the agent has very poor listening skills.

Ideally, the client will meet the agent at the brokerage office and either drive with the agent or closely follow the agent's car while driving to one or more properties to be shown. The agent must confirm that there is a

keybox or lockbox on the property or that there is an occupant who can let them inside before driving out to see each home. For occupied properties, the agent must make sure to schedule enough time to see all of the properties within the estimated window because of the property owners' time constraints or because the home is scheduled for another showing at a certain time.

A showing schedule that the agent can print out and hand to the client can be helpful to them both so they stay on track of their time schedule.

(Sample) Showing Schedule (June 10th)

155 Main Street: 10:00 am to 10:30 am

1736 Vermont Street: 10:45 am to 11:15 am

2294 Sunset Place: 11:30 am to 12 pm

The agent and client might be in some properties for only five or 10 minutes and in other properties for 30 minutes or longer. Creating a 15-minute time cushion between each property might be helpful due to potential time delay factors related to locating the property, or spending several minutes outside of each property talking about what the client liked or did not like about it. The agent should emphasize the positive amenities in each home as well as how attractive the surrounding homes, parks, and schools are in the neighborhood. It is highly recommended that the property owners are *not* there during showings to answer questions, make statements, or interfere with the showing process in ways that could turn the interested buyer away from the property.

While closely listening to any statements made by the clients after viewing a home, the agent should ask some open-ended questions that make the client give detailed responses instead of "yes" or "no" replies. An example of an open-ended question would be "*how would your furniture fit inside the master bedroom?*" This way, the agent is encouraging the client to visualize how this home can work for them and letting the client's

imagination answer the question in any number of ways that may include the need to buy more furniture or to place some furnishings in other rooms.

A **“tie-down”** question and sales strategy is another way to both convey good points about a property and to get the client to respond in a more positive way after they are forced to think more carefully about the question asked. These types of questions can be used to find out which amenities or features in the home are most important to the client. Some tie-down examples may include:

“This is a fun-looking game room, isn’t it?”

“You need at least three bedrooms, don’t you?”

“Your wife and kids really want a swimming pool, don’t they?”

“The kitchen should be large enough for entertaining guests at your annual holiday parties, shouldn’t it?”

After viewing a few properties, the agent should compare and contrast some portions of each home or the entire homes with one another while asking the client their thoughts.

“Did you like the master bedroom more at the Main, Vermont, or Sunset properties?”

“Which property had the best backyard?”

“Which property had the best garage and storage size for you and your family?”

The agent can narrow down a final list of the most favored properties seen in person by the client. The agent can compare the list of the top two or three properties with the client’s original list of desired property features

such as at least 3 bedrooms, 2 baths, 2,000 square feet, close proximity to a certain school, a large backyard, a spacious kitchen, a 2-car garage with decent storage cabinets, and a nice master bedroom.

The agent can then show the client that the final two or three properties all meet the client's desired list of features prior to writing up purchase offers for the property located on the top of the list. Should another buyer buy the most favored property on the list, then the agent can write up offers for the second and/or third property as a backup.

Preparing an Offer

The most commonly used offer to purchase contract in the state is the **California Residential Purchase Agreement and Joint Escrow Instructions** form that is updated every several years. It is used mainly for residential (one-to-four unit) properties and sometimes for some other types of properties.



There are several pages of sections that the buyer's agent and the client must fill out, initial, and sign that include these main sections:

- 1) Offer (buyer's name, offered purchase price, and requested closing date)
- 2) Agency (agency confirmation selected by the client such as single or dual agency)
- 3) Finance Terms (cash and/or third-party financing)
- 4) Allocation of Costs (seller or buyer to pay for which third-party inspection costs)
- 5) Closing and Possession (owner or non-owner occupied and timing requests for possession)
- 6) Statutory Disclosures (lead-based paint, etc.)
- 7) Condominium/Planned Development Disclosures (HOA and CC&R details)
- 8) Items Included and Excluded from Purchase Price (defining which items are considered personal or real property)
- 9) Condition of Property ("as is" or fully-disclosed defects)
- 10) Buyer's Investigation of Property and Matters Affecting Property (buyer either agrees to certain property conditions or asks to inspect further)
- 11) Seller Disclosures; Addenda; Advisories; Other Items (more inspections and disclosure-form options)
- 12) Title and Vesting (buyer states their preference to hold title as "sole and separate," "joint tenancy," or some other vesting option)

- 13) Sale of Buyer's Property (buyer confirms that he does or does not have to sell his other property before the scheduled move-in date)
- 14) Time Periods; Removal of Contingencies; Cancellation Rights (the buyer and seller agree to 7, 10, 17, 21, or 30-plus-day contingency time periods to complete inspections for an appraisal, home inspection, pest, and/or environmental concerns)
- 15) Repairs (the list of any requested repairs to be completed)
- 16) Final Verification of Condition (buyer's right to inspect the completed repairs prior to the closing)
- 17) Prorations of Property Taxes and Other Items (the confirmation that all HOA and property-tax assessments will be prorated to the exact date of closing)
- 18) Selection of Service Providers (a statement that the buyers or sellers may select their own third-party specialists)
- 19) Multiple Listing Service (the brokers acknowledge that they plan to post the property online in the MLS system with the list price, terms, and closing price)
- 20) Equal Housing Opportunity (the property is being sold in compliance with local, state, and federal anti-discrimination guidelines)
- 21) Attorney Fees (the prevailing party in any future litigation dispute shall be required to pay the other party's reasonable attorney fees and court costs)
- 22) Definitions (various terms like "acceptance" and "delivery" are explained)

- 23) Broker Compensation (an agreement to pay broker fees upon close of sale)
- 24) Joint Escrow Instructions to Escrow Holder (separate instructions directly to the escrow company (or other firm) handling the transaction)
- 25) Liquidated Damages (3% of the purchase price (or some other mutually agreed-upon amount) shall be retained by the seller should the buyer default and back out of the deal after the contingency time periods have lapsed)
- 26) Dispute Resolution (mediation or arbitration options are described that are held outside of court)
- 27) Terms and Conditions of Offer (the offer is subject to all terms and conditions included here within the same offer)
- 28) Time of Essence; Entire Contract; Changes (parties are to act as quickly as possible to meet the deadlines outlined in this contract)
- 29) Expiration of Offer (the buyer had an expiration date that may be as short as one, two, or three days before the seller has to accept, counter, or reject)
- 30) Acceptance of Offer (this is the favorite part of the purchase offer for both the buyer's agent and listing agent because the seller has agreed to fully accept the purchase offer)

The final two pages of the purchase offer contract is called the **Buyer's Inspection Advisory** form. It effectively was designed to let the buyer know that they have the right to fully inspect any section of the home on their own or after appointing a third-party inspector to take a tour through the property and make note of their own findings.

The Presentation of One or More Offers

For properties that have multiple parties interested in making offers, the buyer's agent who presents the most attractive and easiest offer to accept will likely end up with the accepted offer. The most appealing offers for sellers are the ones that are at or above the list price, show that the buyer has all cash or a fairly large down payment available plus full loan approval from a local lender, and the wish to close escrow in 30 days or sooner. Some offers may waive all contingency rights such as appraisals, home inspections, and termite and pest inspections if they are planning to buy the home with their own cash.

The agent should make sure that the offer includes the correct property description, the buyer's payment method (i.e., cash, cash plus a loan, cash plus a loan plus seller's financing), and any special contingencies that the buyer is requesting for the property such as a longer than normal time request for an appraisal or home inspection. Both the buyer and agent should look closely at any offer about to be presented to the seller to ensure that nothing of importance was left out. An offer with no conditions attached is called a **clean offer**.

The buyer can **revoke their offer** to purchase at any time up until he or she is notified that the seller has accepted the offer. For accepted offers, the deal then becomes a binding contract between the buyer and seller. The buyer cannot back out of the deal without breaching the contract and facing potential liquidated damage penalties *unless* they do so before the end of the contingency time periods such as for the home inspections, pest inspection, and appraisal.

A purchase offer that is not responded to on time by the seller before the expiration of the offer term will automatically be considered a canceled or terminated offer. Both the buyer and seller can mutually agree to rescind or cancel the deal once in contract without the buyer having to forfeit any earnest money deposit.

A legally valid written offer is one that is complete, includes a definable closing date, and a proposed purchase price. An offer to purchase can be verbal or written. It is advisable that agents make written offers with all of their transactions, if possible, so that nothing is lost in translation during the negotiation process. However, all seller acceptances of purchase offers must be written as a response.

Multiple Counteroffers

Sellers with multiple offers might counter back with the exact same counter to each offer, or they will counter to each individual offer. The buyer who then agrees to the best price and terms being requested by the seller will probably end up with the accepted offer. The second best offer may remain in backup position if the buyer is still interested and not too upset about being outbid for the property.



Sometimes, purchase offers will fall apart over very minor issues like the buyer just changed their mind for no particular reason or they heard some negative feedback about crime in the area, or serious issues such as the fact that the buyer's lender denied their loan after taking a closer look at the property and client. If and when the buyer in first position falls through and the deal collapses, the buyer in backup position should be ready to step up and proceed with the deal.

Good Faith Deposits

There is no state law that requires any buyer to hand over a good-faith deposit (also referred to as the "initial deposit" or "earnest money deposit"). However, most sellers expect one before they will accept a purchase offer. The deposit amount will show the seller that the buyer is seriously interested in purchasing the property. It may also show the seller that the buyer is somewhat financially qualified if they can come up with a \$5,000, \$10,000, or \$20,000 deposit check.

The good faith deposit is usually at or near 3% of the offering price for the property. But it is not set in stone and can be just about any dollar amount that both sides mutually agree to at the time of the signing and acceptance of the offer. California has some of the most expensive real estate in the nation and indeed, the world, so 3% of a \$1 million dollar purchase price is equal to a pretty hefty \$30,000 deposit. A somewhat smaller amount that is agreed to is sufficient. An offer to purchase is sometimes called a **deposit receipt**.

The handling of escrow funds can be one of the riskiest things for a real estate agent that can get them into serious legal and licensure trouble if they do not follow the state guidelines. A buyer can hand the check directly to the seller, the listing agent, the buyer's agent, escrow officer, or some other designated party who is working on the transaction.

The **California Association of REALTORS®** (CAR) purchase agreement

form states that the buyer is required to deliver the good faith deposit to the escrow holder within three (3) business days after the offer is accepted *unless* the parties mutually agree to another time option. The CAR agreement also notes that when a real estate agent or broker receives trust funds, the licensee has three (3) business days to deposit them in or with:

- the Principal;
- a neutral escrow account; or
- the broker's trust account.

When trust funds are handed over to a salesperson instead of the main employing broker, the salesperson must turn over the funds to the broker or designated selling or leasing principal as soon as practicable, or deposit the funds directly into the broker's trust account if the salesperson has written approval to do so. Some offers ask the buyer's agent to hold the uncashed personal check up until the offer is accepted for a period of a day or a few days. If so, the buyer's agent must still deposit the funds within three (3) business days *after* the purchase offer has been formally accepted *unless* the buyer and agent have agreed to different instructions in writing.



Deposit forms: Most types of deposit funds will be placed as a personal or business check, a cashier's check, or wired funds from one account to another. Some personal checks can bounce or be rejected due to insufficient funds after the buyer writes a check for a fairly large amount.

Other banks may place a very long hold on the check written due to fraud concerns because the amount is so large. If a hold is placed on a personal check, it may not clear for a few days or up to two weeks in some cases. Some sellers will not formally accept a buyer's purchase offer until the deposit check has cleared and all funds have been released to escrow or to the broker's trust fund account. This is why so many sellers may demand a cashier's check or a wire transfer so that the funds will clear on the same day or by the next day in most cases.

Liquidated Damages: Liquidated damages is the amount of money that a buyer agrees to pay should he later cancel the contract. The amount must be mutually agreed to by both the buyer and the seller. Many types of purchase contract forms (standard or personalized) have maximum ceiling amounts for liquidated damages of 3% of the purchase price offer. Even if the buyer agrees to write a check for 10% of a \$500,000 purchase price (or \$50,000) and later is unable to qualify for a mortgage loan *after* the loan contingency period of 21 days has expired, the seller may be entitled to keep 3% of the purchase price (\$15,000). However, escrow will probably refund the excess amount (\$35,000) back to the buyer unless other arrangements or written agreements were in place.

Before dispersing any liquidated damages due to canceled transactions or completed transactions that successfully close, the escrow office will usually ask for signed written authority from all key parties involved in the transaction. In the event that one or both sides will not sign the agreement, the escrow office may be forced to forward the dispute over funds to a nearby court, arbitrator or mediator that was mutually agreed to at the start of the transaction. If both parties had agreed that some third-party expenses such as repair costs and inspections could be paid

out of the earnest money deposit funds, then the escrow may still pay those people directly from the deposit funds.

Agents need to realize that if they do not stay up to date with the various contingency steps and deadline dates for the completion of the appraisal, home inspection, termite and pest inspection, and any other third-party inspections, they might be at risk for being sued by their own client for the loss of the client's good faith deposit. It can be very disheartening for agents to have their purchase deals fall apart and not collect one dime of commission after weeks and months of hard work. Of course, it can be even worse when the buyer turns around and sues the agent for their lost \$50,000 earnest money deposit while claiming misrepresentation, incompetence, or fraud because the agent told the buyer the incorrect contingency dates.

Contract Modifications and Amendments

A contract that has been accepted by the seller cannot be modified later because the acceptance makes it a binding agreement between the buyer and seller. However, the buyer and seller can make an **amendment** request (change) after the contract has been executed and up until the very last minute before the escrow closes and the title changes hands from the seller to the buyer.

The buyer may be entitled to request an amendment to the contract after discovering that the roof has a serious leak that was never disclosed before because the seller was not even aware of it. A completed home inspection report that includes remarks about a hidden roof leak that had not been noticed before due to lack of rainfall in recent months or years would be a very valid reason for the seller to agree to pay to fix the roof before the close of escrow. The contract would then be amended from a "zero credit for seller repairs" to, e.g., a "\$1,000 credit for seller repairs" in the updated amendment or addendum form that is also provided as a

standard CAR document.

Canceling Contracts

There can be situations where both the seller and buyer mutually agree to terminate the contract before the deal closes. For reasons as simple as both sides just changed their minds, the buyer and seller will send in their signed cancellation instructions to escrow to end the transaction, refund the earnest money deposit to the buyer, and pay any outstanding third-party fees or brokerage fees that may still be required to be paid.

Any good cancellation agreement that protects the principals and agents should describe how the earnest money deposit should be divided between some or all of the main parties involved. Technically, the buyer's agent and the listing agent did their job acting as the **procuring cause** after bringing in a ready, willing, and able buyer to close with price and terms that were acceptable and formally agreed to by the seller. As a result, both agents were entitled to their full commission amounts per the terms of the signed contracts in place. Often, both agents will agree to split the remaining good faith deposit funds even if the amounts were less than their full commission so that they can avoid a costly legal battle.

For the best protection for the brokers involved, the cancellation agreement should include some type of a **safety clause** in it just like in many listing agreements. The clause might state that should the buyer and seller later change their minds and finalize the sales transaction directly with one another without either brokers' assistance for a period of time up to six (6) or twelve (12) months later, the brokers shall be entitled to collect the full original commission amounts.

Anti-Discrimination Laws

Redlining: When a lender refuses to make a loan in a certain neighborhood due to concerns about the racial makeup of the community, this illegal act is referred to as redlining.

Blockbusting: This illegal act is related to actions such as a broker telling one or more homeowners in a neighborhood that another group of buyers from a different racial background or a different national origin is planning to move into the area. The broker then makes the false claim that property values may go down as a result, so the homeowner should list with him and sell right away.

Market Allocation: The unlawful act is committed by agents who agree to *not* sell properties located in a certain area, or to *not* sell properties to a protected class of people because of their race, national origin, familial status, or other discriminatory reasons. Or the agent may agree to **only** sell properties or work with clients in just one particular area. It is somewhat akin to a combination of a discriminatory action and a **monopolization** technique that may violate national antitrust laws.

Unruh Act: California legislation that specifically outlaws discriminatory actions in businesses such as hotels, restaurants, movie theaters, hospitals, retail centers, or in housing accommodations. The law was enacted back in 1959, codified as California Civil Code §51, and is named for its author, Jesse M. Unruh, a former politician and state Treasurer.

Rumford Act: California legislation that was passed in 1963 as a way to help end racial discrimination by landlords and property owners who refuse to rent or sell their property to “colored” people or other members of protected classes. It is also referred to as the California Fair Employment and Housing Act.

Sherman Antitrust Act: Congress passed the very first antitrust law, the Sherman Act, in 1890 as a “comprehensive charter of economic liberty

aimed at preserving free and unfettered competition as the rule of trade.” This law was enacted to outlaw “every contract, combination, or conspiracy in restraint of trade,” and any “monopolization, attempted monopolization, or conspiracy or combination to monopolize.”

Any actions considered an attempt to monopolize or “corner” one segment of a market due to unfair business practices may be deemed a violation of federal antitrust laws. The agent may be faced with fines up to \$1 million and imprisonment for up to 10 years for such a violation.

Megan’s Law: This law, enacted in 1996, was named after a seven year-old child, Megan Kanka, who was raped and murdered by a known registered sex offender who had moved across the street from her family’s New Jersey home. All registered sex offender names can be found on a database list online by location based on where they live. Agents are required to disclose to clients how to gain access to this list.

Chapter Eight Summary

- Most agents will have first contact with a prospect by way of a phone call, text, or email. New agents might want to ask for as much “floor time” as possible at their brokerage firm so that they can speak with many different prospects.
- Experienced agents with multiple listings may be eager to ask new licensees to handle their open houses, return phone calls from prospects, and set up appointments with prospects. Some new and older agents may volunteer to handle open houses for agents who have the actual listings. This way, the agent handling the open house can work towards becoming a buyer’s agent with prospects he or she meets at the open house.

- **Corporate relocation:** When a company relocates, it is an incredible business opportunity for agents seeking new buyers in large numbers within the same general community. Some businesses might move a hundred to several thousand employees to new areas that are far away from their old headquarters. If so, they will need places to buy or lease within a relatively short time period.
- Due to the financial risks associated with calling someone on a Do Not Call list or emailing them and violating national Spam laws, it is recommended that the agent ask for written permission to contact prospects from past open houses.
- Four topics of interest that can make an agent seem more likeable to a client include Henry Ford's **F-O-R-D** communications and sales technique: Family, Occupation, Recreation, and Dreams. The agent tries to find common bonds and interests as a way to quickly build rapport.
- To reduce **safety risks** for agents, they should work with a partner when visiting a new prospect in a vacant home for sale. Agents should also try to meet new clients for the first time at the broker's office. If an agent must meet at the property, he or she should let others know the exact property address where the agent is planning to meet a new client.
- The most popular offer-to-purchase contract in the state is the **California Residential Purchase Agreement and Joint Escrow Instructions** form. There are sections for the proposed purchase price, agency selected, requested repairs, inspection options, and term to close. The final two pages of the purchase offer contract is called the **Buyer's Inspection Advisory** form, which advises the buyer to complete their own inspections before closing.

- Any offer presented within a specific designated time frame (two to five days) that expires before the seller responds is automatically terminated.
- The seller can respond to **multiple offers** by sending out the exact same counteroffer to multiple parties or offering different responses to each buyer applicant.
- The good faith deposit (also called “earnest money” or “deposit receipt”) is usually at or near 3% of the offering price for the property. There is no state law requiring the payment of a deposit at the start of the escrow. But it makes the buyer seem more committed and financially qualified to the seller. The amount does not have to be 3%; the parties can agree to a different amount.

Chapter Eight Quiz

1. Who can benefit from floor time in the office?
 - A. Agent answering calls
 - B. Employing broker
 - C. Customer who calls
 - D. All of the above
2. A “relo” is a reference to _____.
 - A. Foreclosure action
 - B. Corporate relocation
 - C. Business relocation
 - D. Both B and C

3. Where is the best place to meet a new client in person after first speaking on the phone?
- A. Agent's office
 - B. Customer's home
 - C. At a vacant listed home
 - D. At the agent's home
4. The F-O-R-D method of salesmanship attempts to first ____.
- A. Close the deal
 - B. Find referrals
 - C. Find common interests
 - D. Provide data to the client
5. What percentage of male agents have been attacked or robbed while showing properties or meeting new clients in recent years?
- A. 10%
 - B. 17%
 - C. 25%
 - D. 33%
6. *"You need at least four bedrooms, don't you?"* is which type of a sales strategy for an agent?
- A. Fact, bridge, benefit
 - B. Conversion close
 - C. A tie-down
 - D. Closed-ended statement
7. What paperwork is most often used to write up offers in California?
- A. Earnest Money Deposit form
 - B. California Residential Purchase Agreement and Joint Escrow Instructions
 - C. Buyer's Agency and Offer form
 - D. California Residential Purchase Contract form

8. The two pages at the end of a standard purchase form in California is called which form?
- A. Buyer's Inspection Advisory
 - B. Seller's Disclosure
 - C. Agency Confirmation
 - D. Buyer's Term Sheet
9. What can the buyer do after making an offer to purchase a property before the seller has responded?
- A. Wait until the seller has responded
 - B. Modify their offer
 - C. Withdraw the offer
 - D. Both B and C
10. What is the minimum good faith deposit that must be included with a purchase offer in the state?
- A. Zero
 - B. \$10
 - C. 1% of purchase offer amount
 - D. 3% of purchase offer amount
11. What is the usual time period that a buyer should deliver their good faith deposit after the seller's acceptance?
- A. 1 day
 - B. 3 calendar days
 - C. 3 business days
 - D. 5 business days
12. What is a change to a contract called that takes place after the seller's original acceptance?
- A. Modification
 - B. Amendment
 - C. Revocation
 - D. Revision

Answer Key:

1. D	6. C	11. C
2. D	7. B	12. B
3. A	8. A	
4. C	9. D	
5. D	10. A	

CHAPTER 9

FINANCING PROPERTIES

Overview

The ease of access to third-party capital funding sources is usually the driving force behind whether a housing market is booming or busting at a specific time. The vast majority of buyers and sellers need third-party loans to get into and out of properties. In this chapter, we will cover the various steps necessary for mortgage loan applicants to qualify for real estate funds as well as explain why and how interest rates and underwriting guidelines can change so drastically over time.



Monetary Policy

The actions of a central bank such as the Federal Reserve (the “Fed”) or some other type of financial regulatory board that directly impacts the rate of growth of the money supply is the core of the nation’s monetary policy. Three of the main strategies for influencing the money supply include the modification of short-term interest rates, the buying and selling of government bonds, and the changing of reserve requirements for banks that either limits or increases the amount of funds that they can lend to their banking customers.

Which agency or group impacts monetary policy the most?

There are two main types of monetary policy strategies that the Fed will promote during positive, stagnate, or negative economic cycles: expansionary and contractionary.

Expansionary: This economic period of time is when the Fed attempts to stimulate economic growth by taking action that allows consumers to gain more access to the money supply. These “easy money” type actions might include: (1) the lowering of short-term rates for consumers and borrowing banks; (2) the easing of bank reserve requirements that allow financial institutions to lend out more money while saving less cash in the bank’s vaults or digitized balance sheet; and (3) easing mortgage underwriting guideline requirements as a way for more borrowers to qualify for loans.

When national unemployment rates are too high and asset prices (real estate, stocks, bonds) are sluggish or on the downward descent, the Fed is more likely to ease access to the money supply for both consumers and banks.

The years between late 2008 and 2017 are very good examples for expansionary monetary policies after the Fed kept lowering short-term

interest rates to near zero targets. Both short and long-term interest rates reached record lows thus far at that time. One of the biggest fears of the Fed over the past 10 or 12 years has been asset deflation for falling real estate values and stock prices. To combat falling asset prices, the Fed worked to ensure that borrowers would have access to record low mortgage rates and payments so that asset value prices would be boosted once again.

An example of a monetary policy swing from one that is more expansionary to a slower change back to a contractionary one (discussed below) can be seen with the Fed's rate hikes in 2017 from record low-rate levels. These are key short-term rates in December 2017 as compared with the previous year:

Index	Interest Rates	Interest Rates
	December 18, 2017	December 18, 2016
WSJ Prime Rate	4.25%	3.50%
Federal Discount Rate	1.75%	1.00%
Fed Funds Rate	1.50%	0.50%
11th District Cost of Funds	0.73%	0.59%

And by December of 2020, the prime rate had fallen to 3.25%, the federal discount rate and the Fed Funds rate were both well below 1% at .25%, and the 11th District Cost of Funds rate was .5%.

Contractionary: The Fed's stated number one fear is inflation. Inflation is like a hidden form of taxation that severely damages the purchasing power of the dollar. Since the Federal Reserve opened its doors back in 1913, the value of a dollar has fallen so far that the same dollar now has about two or three cents of purchasing power. During periods of time when the reported annual inflation rates are moving too quickly skyward, the Fed has typically raised short-term rates for borrowers and member banks, decreased the amount of money available to the financial markets,

The 1970's had some of the highest rates of inflation in U.S. history due to factors related to the modification of the currency system after the dollar was changed from gold-backed to an oil-based one with the introduction of the Petrodollar system in the early 1970's. Home prices began to escalate at a faster pace than they had in previous decades, especially in California. The Fed's stated goals were to contain or quash inflation as it steadily increased interest rates in the late 1970's.



<u>Date</u>	<u>Rate</u>
August 16, 1979	12.00%
August 28, 1979	12.25%

September 7, 1979	12.75%
September 21, 1979	13.25%
September 28, 1979	13.50%
October 9, 1979	14.00%
October 23, 1979	15.00%
November 1, 1979	15.25%
November 9, 1979	15.50%
November 16, 1979	14.75%
November 30, 1979	15.50%
December 7, 1979	15.25%
February 19, 1980	15.75%
February 22, 1980	16.50%
February 29, 1980	16.75%
March 4, 1980	17.25%
March 7, 1980	17.75%
March 14, 1980	18.50%
March 19, 1980	19.00%
March 28, 1980	19.50%
April 2, 1980	20.00%
April 18, 1980	19.50%
May 1, 1980	18.50%
May 7, 1980	17.50%
May 16, 1980	16.50%
May 23, 1980	14.50%
May 30, 1980	14.00%
June 6, 1980	13.00%
June 13, 1980	12.50%
June 17, 1980	12.00%
July 7, 1980	11.50%
July 25, 1980	11.00%
August 22, 1980	11.25%
August 27, 1980	11.50%
September 8, 1980	12.00%
September 12, 1980	12.25%
September 19, 1980	12.50%
September 26, 1980	13.00%
October 1, 1980	13.50%
October 17, 1980	14.00%
October 29, 1980	14.50%
November 6, 1980	15.50%

November 17, 1980	16.25%
November 21, 1980	17.00%
December 2, 1980	18.50%
December 5, 1980	19.00%
December 10, 1980	20.00%
December 16, 1980	20.00%
December 19, 1980	21.50% (record high)

The interest rate “pendulum” swung back and forth from lower to higher and back to lower before moving higher to reach the record high rate of 21.50% on December 19, 1980. As compared with December 2016 (3.50%), the Prime Rate in 1980 was 18% higher. The Fed had scrambled to try all sorts of monetary policy strategies as a way to combat annual inflation rates that varied from 10% to 15% in some of the later years in the 1970’s and 1980’s.

Note that the inflation rate in November 2020 was 1.2%!

Open Market Operations

The Federal Reserve’s decisions to either buy or sell government securities in the open market as a way to expand or contract the national money supply is known as the **open market operations**. The purchase of securities injects fresh new money into the banking system while usually stimulating economic growth. The sale of securities, on the other hand, will reduce the available supply of money while slowing down or contracting the economy.

The **Federal Open Market Committee (FOMC)** is the Federal Reserve’s main committee that decides on which type of monetary policy will be selected at a certain time in an economic cycle. The FOMC shall enact its monetary policy by the establishment of a target **Federal Funds Rate** that it will attempt to reach after modifying open market operations, the **discount rate**, and the reserve requirements for member banks.

The FOMC will usually meet at least eight (8) times per year to discuss the latest target fed funds rate and the best ways to quickly reach these new rate forecasts by way of open market operation actions. Some years, the Fed will meet more than eight times when it is really concerned about the latest economic trends that might be deemed “too positive or strong” (high inflation and low unemployment rates) or “too negative or weak” (declining asset prices and higher unemployment rates). In these “emergency meetings” at the Fed, the committee might increase or decrease rates by a much higher or lower amount such as in increments of 0.50% or more instead of the usual 0.25% rate changes up or down.

Federal Funds Rate: This is the rate at which depository institutions or banks lend reserve balances to other banks on an overnight basis. Any excess funds that are not loaned out to other banks or customers are held to maintain reserve requirements. The **Discount Rate** is the minimum rate set by the Federal Reserve for lending to other banks.

Fiscal Policy



Government spending and taxation strategies that influence the overall economy are referred to as **fiscal policy**. While monetary policy is influenced the most by the actions of the United States' main central bank, fiscal policy is impacted more by decisions made by the U.S. Treasury, Congress, or the sitting President through his executive-order actions or other political options.

Generally, the fiscal policy will closely mirror the actions of monetary policy so that the overall economy may expand or contract. Fiscal policy also has expansionary and contractionary intentions or desired outcomes just like monetary policy.

To expand an economy, the government may cut personal and corporate tax rates and increase spending so that more money floods to consumers. To contract or slow down an economy due to inflation concerns, the government might decide to increase personal and business tax rates and decrease spending. Increased government spending on public works projects such as the construction of new highways, roads, schools, and parks can create thousands or tens of thousands of new jobs across the nation which can lower the national unemployment rate and add more money to the financial system.

Taxation provides a major source of revenue that helps to fund the government. Individuals, businesses, and investments are taxed at different rates that may fluctuate from low to high and back to low, depending upon whether the economy is sluggish or moving at a faster pace. When capital gains rates are lowered, it encourages more investors to acquire properties and stocks that they will hold for either short term or long term. When the rates are moved too high, investors might have fewer dollars to invest.

The Primary Markets

The **primary mortgage market** is the main place where customers go to find a loan. The best examples include community banks, credit unions, and savings banks that are located within walking distance of or a short drive from a person's home in the same community. There are also online lenders in the primary mortgage market, and they may be based nearby or on the other side of the country.

Most people will spend the highest percentage of their lifetime income on real estate either in mortgage payments (or rent). Each year, the amount of money paid for real estate might vary from a low of \$10,000 to as high as \$100,000 or more depending on the size of the mortgage, the interest rate, and the loan term. As a result, most borrowers these days will shop around for the lowest rates and the widest choice of loan-term options to keep their payments as low as possible.

Primary financing refers to the first loan recorded against a property being purchased or refinanced. Loans that are in first position are considered much safer than junior loans (or secondary financing) that can be in second, third, or fourth position behind the first mortgage. As such, the interest rates are much lower for first mortgages than for junior loans.

Institutional Lenders

Borrowers with the best banking relationships, credit histories, and the steadiest income will probably find their mortgage loans from some type of institutional lender that offers the lowest rates and fees. Institutional lenders are required to follow more stringent government regulations, and usually have the option to sell off most of their funded mortgage loans to secondary-market investors, which may be government-backed or insured. Let's review below some of the most common or prevalent

institutional lenders:

Commercial banks: This is the most widespread or popular type of financial institution across the nation. A commercial bank is a depository institution that will take its clients' deposits (checking and savings), and lend the money back out to other customers. A commercial bank will often make shorter-term loans to its banking customers because most of the customers' deposited funds are also for shorter time periods that may last from months to several years. A commercial bank may offer an automobile loan, a business loan, a home-equity loan, or a construction loan to its customers over a period of one, two, or three years to its best customers at the lowest rates.

Savings banks: This type of financial institution may also be referred to as **savings associations** or **thrifts** (formerly known as "savings and loans"). Just as with banks, they can be state chartered here in California or federally chartered in that they are required to follow federal guidelines or laws. Historically, these types of banks paid higher deposit rates to their customers for much longer time periods so that they could lend out longer-term mortgage loans or construction loans for both residential and commercial properties. The loan-to-value options for borrowers is usually much higher for customers of savings banks with 95% LTV loans being more of the norm over the past few decades.

Life insurance companies: A life insurance company can be state or federally chartered as well. These financial institutions will often make much larger loans for residential construction projects or for commercial properties such as retail shopping malls, apartment buildings, or high-rise, Class A office buildings that are located in prime metropolitan regions. In California and other states, a life insurance company may offer a new loan up to 75% of a property's purchase price or current market value for loan terms up to 25 or 30 years. A life insurance company may also offer funds as a type of mortgage debt, equity with shared ownership or participation interests, or some combination of both.

The Secondary Markets

Lenders who fund in the primary market will later need to sell off most of those loans to secondary market investors so that they don't run out of cash or credit. There are four main secondary market investors out there today, which specialize in purchasing various types of residential and commercial mortgage loans from primary-market lenders. These secondary mortgage market investors include:

Fannie Mae: In 1938, the Federal National Mortgage Association (FNMA or "Fannie Mae") was established as a new way to stimulate the housing market while also increasing consumers' faith in the financial markets and overall economy. Between 1929 and 1939, many Americans who lived through the Great Depression lost their jobs, homes, and families at a pace never seen before in U.S. history. In the years 1932 and 1933, especially, there were many "bank runs" where depositors would literally run to their bank to pull their cash out before the bank imploded and went out of business. Many of the banks at the time were in financially worse shape than their own customers.



The formation of Fannie Mae near the near the end of the Great

Depression years helped to restore confidence in both the financial and housing markets by offering banks the opportunity to quickly sell off their funded mortgage loans in the secondary mortgage market. Fannie Mae offered much needed new capital to banks that could be passed onto customers.

Specifically, Fannie Mae first began focusing on the investment of funded FHA and VA-guaranteed mortgages. The **Federal Housing Administration (FHA)** was established after the passage of the **National Housing Act of 1934**. It was FHA that set the standards for construction and home mortgage underwriting while insuring some portion of the funded loans made by banks at the time. Because banks knew that some of their mortgage debt was insured by FHA, they could take more risks and offer loans at much higher 95% LTV rates. These same funded FHA loans would then be easily sold off to Fannie Mae prior to the banks later making new loans to customers.

In 1968, Fannie Mae went from an entity that was a government-owned and controlled one to a more private, profit-oriented corporation that was publicly traded as a stock. Fannie Mae might create “pools” or “packages” of millions or billions of dollars of similar properties or loan amounts and sell off smaller pieces of the loan packages to financial institutions or individual investors on Wall Street. The sale of an “income stream” or piece of a larger pool of capital is also referred to as the “**securitization of debt**” in secondary markets and across other financial markets.

Freddie Mac: The **Federal Home Loan Mortgage Corporation** (FHLMC - a/k/a “Freddie Mac”) was founded with money provided by the 12 Federal Home Loan Banks. It was set up as a federally-chartered corporation on July 24, 1970 by Congress. Freddie Mac helped increase the supply of capital for residential loans by buying and selling small and large pools of funded mortgages at such high dollar amounts that eventually would pass the \$1 trillion dollar mark by 1993 (23 years later).

Fannie Mae and Freddie Mac Bailouts: In 2008, the federal government had to step back in and take over the control and management of both Fannie Mae and Freddie Mac after millions of loans in their portfolios had defaulted or gone all the way through to foreclosure. The federal government was so concerned that the bankruptcy or loss of Fannie Mae and Freddie Mac would negatively impact the housing and overall financial markets so severely that they had no other choice but to step in and take over control. The conservatorship or supervision of the two largest secondary mortgage market investors would be run by the **Federal Housing Finance Agency (FHFA)**.

Ginnie Mae: The **Government National Mortgage Association** (GNMA or “Ginnie Mae”) is a wholly-owned government agency that was created in 1968 as a division under the U.S. Department of Housing and Urban Development (HUD). Ginnie Mae was designed as a way to offer liquidity options for various types of government-backed or insured mortgages related to FHA, VA, and the Rural Housing Administration (RHA).

Farmer Mac: The **Federal Agricultural Mortgage Corporation** has been both a government-chartered and private corporation in more recent years at different stages of its existence. It is a vital part of the agricultural credit markets and focuses on improving capital sources for mortgage loans that are secured by farm and rural housing properties.

Real Estate Funding Sources

-Mortgage Brokerage Companies

California has two regulatory agencies for mortgage brokers: the **California Department of Corporations** (under the governance of The Department of Business Oversight, or DBO) and the **California Department of Real Estate (CalDRE)**. Each regulatory agency has its own rules and regulations that a licensee must follow. A broker licensed under CalDRE can usually work with most banks, credit unions, and

other types of lenders in general. A licensee under the Department of Corporations and DBO may only negotiate loans with lenders licensed by the **California Finance Lenders Law**.

The **SAFE Act (The Federal Secure and Fair Enforcement Mortgage Licensing Act)** was created shortly after the start of the ongoing Credit Crisis that began to worsen in the fall of 2008. The intent of the act was to increase the licensing and education requirements for mortgage professionals across the nation. The SAFE Act was implemented as a way to reduce mortgage fraud and better protect consumers with improved mortgage loan cost disclosure forms and other paperwork.

The SAFE Act applies to anyone who offers mortgage loans for owner-occupied residential properties (one-to-four units). A new MLO (Mortgage Loan Originator) license was required for mortgage brokers after the passage of the SAFE Act. The license endorsement must be renewed every 12 months by the end of December.

A mortgage broker, banker, or brokerage firm may offer funds from many different lenders, their own lines of credit (or “warehouse lines”), and/or from private funds. A mortgage brokerage firm may receive daily updated rate sheets from each lender that it will offer to its clients. A mortgage brokerage company source is currently the number one source for mortgage loans in the state of California.

Most customers prefer the opportunity of comparing and contrasting rates, terms, and fees with multiple lenders through their loan broker so that they will find the best rate and terms possible. Because finance can be fairly complicated for most people, a high percentage of mortgage applicants prefer the assistance of a qualified and experienced mortgage loan officer who can walk them through the lending and funding process.

A mortgage company can make money on their funded loans in a variety of ways. First, the mortgage broker will probably charge some type of

loan-origination fee that is equal to a percentage of the funded loan amount.

The origination fee for a \$500,000 first mortgage loan, for example, might vary such as the rates and fees listed below:

\$500,000 mortgage loan	
<u>Loan Origination Fee Rate</u>	<u>Fee</u>
0.50%	\$2,500
0.75%	\$3,750
1.00%	\$5,000
1.50%	\$7,250
2.00%	\$10,000

A mortgage broker may also collect a **rebate fee** in addition to or in lieu of a loan origination fee. Some borrowers will agree to pay an interest rate amount slightly higher (i.e., they will pay a $\frac{1}{8}\%$, $\frac{1}{4}\%$, or $\frac{1}{2}\%$ higher mortgage rate over the life of the 30-year mortgage) to avoid paying any loan origination fee. A loan priced at **par** (or the best rate available on the day that it is locked in and priced with no cost or rebate option) might be considered by many borrowers who are willing to pay their broker a loan origination fee because they want the lowest rate possible for the longest loan term.

Other mortgage companies will collect fees by handling the **mortgage loan servicing** for their funded loans. A serviced mortgage loan is one where the mortgage brokerage firm handles the collection and disbursements of client payments each month that are then forwarded to the primary or secondary market investors. The mortgage brokerage firm will collect a small percentage of the monthly payments for agreeing to collect the payments from the mortgage borrowers.

Sometimes, mortgage brokerage companies might hold off the sale of their funded mortgage loans to other investors if they think that rates are headed higher in the near term. If and when the interest rates drop in the near future, the value of the mortgage firm's funded capital pool will probably be higher and might sell at a higher price (or "premium") above the face amount of the loan portfolio.

If the mortgage company engages in fraud by helping the borrower provide phony documentation such as tax forms or bank statements, that mortgage company might later be forced to buy back the loan from any lender or secondary market investor who either originally funded the loan or purchased it in the secondary market. The lender may be faced with civil, criminal, and licensure fines or restrictions that could force the mortgage broker or the entire firm to leave the profession completely.

-Credit Unions: Many years ago, a person would need to be a member of a union or a shared specific profession such as an engineer or teacher to qualify as a new customer for a credit union. Historically, credit unions were primarily owned by their banking customers who held "shares" or types of stocks in their financial institutions. In more recent years, several California-based credit unions have opened up their qualification-guideline requirements so that more people could become customers of credit unions.

Membership in credit unions has expanded to include spouses and children of union members as well as local community residents with no direct or indirect union membership interests. However, most credit unions still prefer making loans that are more local or community-based such as home purchase, small business, construction, and home equity loans. Credit unions can also offer pension fund management and stock and bond investment advice services for their customers. In many ways, more modern versions of credit unions resemble commercial banks.

-Pensions: Pension funds from individual investors or from larger pooled retirement accounts have been some of the best sources of capital for

both residential and commercial properties over the past several decades. Most pension investors want some sort of a combination of higher yields and relative safety for their retirement funds. Many pension investors perceive real estate investments that may be secured as a first trust deed at a lower 60% LTV rate as a much safer investment option than a stock that could eventually go to zero if the company ends up filing for bankruptcy protection. Pension funds especially like newer apartment buildings with low vacancy rates and Class A office buildings that have financially stable tenants with signed lease agreements for years or decades.

-REITs: The Real Estate Investment Trust (REIT) concept was first created back in 1960 to inspire small investors to pool their funds together to raise venture capital for investment into various types of real estate properties. Each REIT is required to have at least 100 financially qualified investors. At least 90% of the annual income received from rents or property sales must be distributed annually to each investor.



REITs, especially, like to invest in larger retail shopping malls or multifamily apartment buildings because these property types can generate hundreds of thousands or millions of dollars each year in rental income. A REIT can be structured as a mortgage, an equity REIT with ownership interests, or as some combination of both mortgage and equity interests in the property where the REIT is both a partial or full lender and investor in the property. The U.S. has the largest market share of REITs in the world with a market cap size surpassing \$1.3trillion as of 2019.

-Crowdfunding Platforms: A crowdfunding platform for real estate is almost akin to an online version of a REIT. Most people probably think of a crowdfunding platform as a way to raise funds for someone who is faced with financial hardship due to high unexpected medical bills or the recent loss of their job. Yet, there have been a fair number of crowdfunding platforms based in California and across the nation that raise capital from financially solid and experienced investors, pool the funds together in increments of hundreds of thousands, millions, or billions of dollars, and offer funds as a form of debt or equity to creditworthy borrowers or prime properties.

A crowdfunding platform essentially eliminates the “middleman” (or the bank) and shares much higher rates of return directly with the investors instead of giving the bank the largest share of the profit. After checking and savings account rates went down to the 0% to 1% at most banks over the past several years, more and more investors became attracted to crowdfunding platform options that offered 7% to 10% annual rates of return on investments. Those investments were and are typically secured by high quality properties that the investor could see online after reviewing the photographs and income histories or projections.

Conventional, Jumbo, and Government Loans

Since 2010, the vast majority of funded residential loans for owner-occupants have been either FHA or VA-guaranteed mortgage loans. These loan programs offer some of the lowest rates, fees, and down payment requirements as well as the most flexible and easiest mortgage underwriting guidelines for qualification.

FHA

The loan requirements that need to be met to qualify for a new FHA loan as of 2017 and updated in 2020 are contained in a “handbook” that is published by the U.S. Department of Housing and Urban Development. One of the main benefits of the FHA loan option is that FICO credit-score requirements can be much lower than conventional loans offered by commercial banks. In fact, some FICO scores can be as low as 500 to qualify for certain types of FHA loans.

Anyone who qualifies for an FHA loan may apply for one. A person does not need to be a current or past government employee or military veteran. The loan fee that most likely will be charged is around 1% of the funded mortgage-loan amount plus a monthly mortgage insurance premium (MIP) fee that shall be paid as long as the existing mortgage is above 80% LTV of the current market value. The monthly MIP fee might average at least \$100 per month for some FHA loan amounts. The fee is paid to an insurance pool that covers a portion of the funding lender’s losses should the property later go all the way to a foreclosure sale.

To qualify for the lowest FHA down payments of 3.5% cash down, a borrower must have a 580 FICO credit score. Other borrowers with FICO credit numbers in the 500 to 579 range must put 10% cash down to qualify. The borrower must have established at least two types of credit account histories such as an automobile loan or a credit card, and not have any delinquent debts that are federally related such as for taxes or a

past foreclosed FHA-insured mortgage loan debt. Borrowers may receive gifts from family members or close associates that may apply towards some portion of the down payment.

FHA allows much higher qualifying debt-to-income ratio requirements that can be as high as 50%. A **debt-to-income ratio** is a mortgage underwriting formula used by bankers when qualifying their applicants. The mortgage applicant's proposed new monthly mortgage payment (principal, interest, property taxes, and insurance) is added to other fixed monthly debt payments (automobile, credit card, and student loans) divided by the borrower's gross monthly income. A debt-to-income (DTI) ratio of 50% would be the equivalent of \$2,500 in monthly payment projections after factoring in the proposed new mortgage payment, and dividing it by the borrower's \$5,000 in monthly income ($\$2,500/\$5,000 = 50\%$ DTI).

The FHA loan limits for properties in California can vary widely depending upon the county where the property is located. As of January 21, 2021, for the counties with a lower median home price, the maximum FHA loan amount may be capped at \$356,362 for a single unit (single-family home, condominium, or townhouse). In other pricier regions near prime coastline areas, such as Newport Beach, Malibu, or Santa Barbara, the maximum FHA loan amount limit as of January 21, 2021, is capped at \$822,375.

There are also much higher FHA loan limits for owner-occupied duplex (two units), triplex (three units), and fourplex (four unit) properties as of 2021 that can range from a low of a maximum loan ceiling amount of \$476,275 to as high as \$1,053,000 for duplexes, \$551,500 to \$1,272,750 for triplexes, and \$685,400 to \$1,581,750 for four units.

There are two divisions under FHA that offer consumers loan options that are government insured:

Title I: Loans for repairs or construction remodeling purposes that will modernize existing properties.

Title II: These are the FHA loans that are used for the purchase or new construction of residential (one-to-four unit), owner-occupied properties. Section 203(b) of Title II represents the bulk of most residential loans funded with FHA backing.

A portion of or the entire 3.5% minimum down payment for most types of FHA loans may be gifted from a family member or close associate. However, there is a limit in regard to credits from the seller and nonprofit group assistance.

VA: The Servicemen's Readjustment Act of 1944 (GI Bill) was passed and enacted near the end of World War II. It was designed with the intent to assist current and former members of the military with new funding sources to purchase homes for their families shortly after their military service ended. Since 1944, millions of homeowners have used VA-guaranteed loans to purchase their family's homes.

It is not the VA (Department of Veterans Affairs) which makes the loan directly to the consumer or borrower. Rather, the VA guarantees a portion of the mortgage loan amount in the event that the property later goes into foreclosure, making the loan less risky for the lender.

One is likely eligible for a VA loan if:

- He or she is on active duty and has served 90 continuous days.
- He or she is a veteran who meets length-of-service requirements, which generally is 90 days in wartime and 181 days in peacetime.
- He or she completed 90 days of active-duty service or six creditable years in the Selected Reserve or National Guard.
- He or she is the surviving spouse of a veteran who died while in service or from a service-connected disability and he or she has not remarried. Or he or she remarried after age 57 or Dec. 16, 2003. Spouses of service members missing in action or prisoners of war are also eligible.

A veteran may still qualify even if he or she does not meet the length-of-service requirements in some cases, such as being discharged for a service-connected disability. A veteran may *not* be eligible if he or she received an "other than honorable," bad conduct or dishonorable discharge, although he or she can apply with the VA to upgrade their discharge status.

If qualified, the VA will issue a Certificate of Eligibility (COE) letter for the VA loan applicant that will be presented to the mortgage company or bank at the time of application.

The Blue Water Navy Vietnam Veterans Act of 2019 eliminated VA loan limits, starting Jan. 1, 2020, for veterans and service members with full entitlement to VA loans.

But service members and veterans who have one or more active VA loans, or who have defaulted on a VA loan, will still be subject to loan limits. For a single-family residence in a typical U.S. county, the limit in 2021 is \$548,250. That is the maximum a VA loan borrower subject to the limit can finance for no money down in those counties.

In California, low-cost counties, like Alpine and Mono, have 2021 VA loan limits of \$548,250, which is the same as the typical U.S. county noted above. Higher limits are established in high-cost counties, such as Los Angeles, Orange, and San Francisco counties, where the loan limit for a one-unit residential home in 2021 is \$822,375, with down payment options as low as zero percent (0%).

The percentage of the loan amount guaranteed by the VA can be as high as up to 50% of a mortgage, up to a \$45,000 loan limit. For loans between \$45,000 and \$144,000, the minimum guaranty amount is \$22,500, with a maximum guaranty, of up to 40 percent of the loan up to \$36,000, subject to the amount of entitlement a veteran has available.

The bank will appoint an appraiser approved by the VA prior to the appraiser completing a Certificate of Reasonable Value (CRV) report that is needed for insurance purposes. It is especially important to the VA that the appraiser is qualified and honest when he or she completes the appraisal report because most of these loans are 100% LTV loans with

zero down payment requirements. The VA wants to ensure that the property is not valued well below the purchase price at the time of the appraisal, or the true loan-to-value numbers might be closer to 110% LTV (or “upside down” at the time of purchase as the loan debt exceeds the market value).

CalVet loans: The California Department of Veterans Affairs (CalVet) offers mortgage loans to the approximately 1.5 million veterans currently living in the state. A CalVet loan rate can be even lower than the best available VA rates offered across the nation.

The CalVet loan differs from a traditional VA loan in that the title to the property actually transfers to the State of California first before being offered to the veteran under a land contract. As with other forms of land contracts or similar seller financing strategies, the seller still retains legal interests in the property while the buyer is given equitable title to the property up until the land contract is fully paid off at the end of the loan term or refinanced with a new loan once some equity has been built up over time.

Many CalVet loans have a loan origination fee that is based on 1% of the funded mortgage loan amount. Other types of CalVet loans can have a funding fee rate that may range from 1.25 percent to 3.30 percent of the loan amount. The state of California raises funds for CalVet loans by issuing tax-exempt bonds.

The current interest rate for a CalVet 30-year fixed-rate mortgage is approximately 2.9%.

The California Housing Finance Agency (CalHFA): This is a self-supporting housing bank that offers first-time homebuyers financial assistance by way of fixed-rate conventional and interest-only mortgage loans at almost the lowest rates possible. Additionally, CalHFA has offered down payment and closing cost assistance programs in certain years for mortgage applicants, and it stopped offering them due to financial constraints as occurred in 2008. CalHFA raises capital through

the issuance of a tax-exempt bond program as opposed to using taxpayers' funds. There are loan programs available for applicants in the low-income to moderate-income range levels.

Loan Qualifications

Real estate professionals should strongly encourage their buyer prospects to get formally pre-approved for a mortgage loan *before* the agent spends too much time with them showing them around the town or city looking at numerous properties. Unless the buyer prospect has 100% of his or her own cash to buy a new property, the odds are quite high he or she will be seeking a mortgage loan amount that will represent at least 90% to 96.5% of the purchase price. In order to qualify for a loan amount that high, the lender will likely put the borrower through a fairly challenging loan-qualification process.

To get pre-approved from a local lender either found directly by the borrower applicant or through a referral from the real estate agent, the first step in the loan qualification process is the completion of the 1003 application for residential properties. In addition to the completed 1003 form, the lender will probably request the following items from the borrower before they can complete the mortgage underwriting process:

- Last two years' W-2 forms (or tax returns if self-employed);
- Last two pay stubs;
- Last two months' bank statements (all pages);
- Latest copy of an investment statement (stocks, bonds, etc.);
- Latest copy of a pension statement (IRA, Sep-IRA, 401-K);
- A check for the costs associated with ordering a credit report; and
- A letter of explanation for any negative items on the borrower's credit report

Sellers are more likely to accept offers from buyer prospects who already have been formally pre-approved for property prices and requested loan

amounts that are similar to the buyer's offering price. During strongest housing-market cycles, a seller may be presented with multiple offers. If each offering price is the same, the seller is more likely to accept the offer from the buyer candidate who has already been formally pre-approved by their lender.

Income and Expense Underwriting

A borrower applicant should understand the basic minimum **qualifying standards** or **loan underwriting standards** at the time they submit their completed 1003 loan application along with financial documents to the lender. During the loan underwriting process, the lender or mortgage brokerage office will analyze both the borrower and the property individually and together. The lender wants to make absolutely certain that the borrower is financially sound and creditworthy, and also wants to know if the collateral for the loan (the property) has sufficient value at the time of application in order to reduce the lender's risk.

Lenders may consider the "3 C's" when determining whether a borrower applicant is worth the risk before they approve their loan request. **The "3 C's" are: Character (credit history), Capacity (income and assets), and Collateral (property value).**

The evaluation of a borrower's risk potential can be broken down into these three questions:

- 1) Does the borrower have enough cash reserves to cover the required minimal down payment amount and closing costs?
- 2) Can the borrower make the projected monthly mortgage payments on a timely basis over the life of the loan as evidenced by the past track record of income and expenses?

- 3) In the event the borrower defaults at a later date, will the collateral (the property) be valuable enough to cover the unpaid amount still owed to the lender?

Each time the bank, loan officer, or mortgage broker funds a loan, they are usually collecting commissions and fees. The more loans that are funded, the more money the financial groups, brokers, and employees earn. An exception to this rule about “more funding equals more income” is when too many borrowers later default on their mortgages and the funding bank is expected to cover the losses. If enough borrowers default on their loans, partly due to relatively easy mortgage underwater standards, then the bank, mortgage underwriters, and loan officers who signed off on these loans may soon be out of a job or out of business.

Lenders that fund loans that are saleable in the secondary market to investors such as Fannie Mae or Freddie Mac will have underwriting guidelines at the bank that are the same as the secondary market investors. Why? The lender wants to be as certain as possible that they can sell off the loan shortly after funding it to Fannie Mae, Freddie Mac, or some other investors so that the lender can continue to make new loans to borrower applicants and not run out of cash or credits. These loans are known as **conforming** or **conventional** loans because they have met the stringent guidelines established by Fannie Mae and Freddie Mac.

Some conventional loans may have fewer underwriting requirements and faster processing times than government-backed loans like FHA and VA loans. Again, the government loans are easier to qualify for since they allow higher debt-to-income ratios and fewer assets. But the government-backed loans usually take the longest time to fund.

When the loans do not meet the standards set by Fannie Mae and Freddie Mac, they are likely to be referred to as **nonconforming** loans. A nonconforming loan can be one that is too large (also referred to as a “**jumbo**” loan) or a mortgage with a borrower with higher debt-to-income

ratios or lower cash reserves than required for conforming loans.

Most conforming loans will be run through an **automated underwriting** computer software system. Fannie Mae and Freddie Mac may have their own versions of automated underwriting systems (AUS) that lenders can also use to make sure that the loans are saleable in the secondary markets. Or, lenders might create their own forms of automated underwriting systems for different types of loan programs available to them, which may include FHA, VA, Jumbo, and “EZ Doc” private lending programs.

The automated underwriting system will analyze the mortgage applicant’s 1003 form loan application and their FICO credit report profile that uses one, two, or three merged credit reports from Experian, TransUnion, and Equifax (the three credit-reporting agencies) before accepting or denying the mortgage application at almost a moment’s notice or keyboard click. If the loan is denied for one specific loan program that was intended to be sold off to Fannie Mae or Freddie Mac, the loan program may offer one or more alternative mortgage loan program options that the bank or mortgage broker can offer to the customer.

For most mortgage loan programs, the lender and assigned mortgage underwriter will likely be looking at three main determining factors before approving or denying a loan application: 1) income; 2) net worth; and 3) credit history.

Income: A mortgage underwriter will decide how much of a borrower’s past income history is stable, fairly consistent, durable, and likely to continue at the same rate in the future. This is true whether or not the borrower applicant is an employee, a self-employed business owner, a retiree or investor, or has some combination of two or more different income sources.

For employees who are union members at a place of business for more than 10 or 20 years as a teacher, police officer, or nurse, the fact that

their employer is a state agency or a multi-billion-dollar corporation should make their job and income fairly stable, consistent, and more likely to continue forward at least at the same pay rate. The mortgage underwriter will take a close look at the applicant's base income plus review their past bonuses, overtime, and/or commissions paid for the year to date or over the past two years when trying to factor in the highest income amounts possible.

Conversely, a self-employed business owner in a brand new company with a very brief history does not really have too much stability or income quality to show to their lender. If the borrower has started a business in an unrelated field as compared with previous jobs (e.g., the borrower started a new restaurant even though his background was as a carpenter), the lender will probably view this new job as highly unstable and risky, and will probably deny the loan. Upwards of 90% of new independent restaurants that are not part of a national franchise chain eventually may fail within the first three to five years, so the restaurant industry is considered one of the riskier business ventures for many lenders. Most lenders like to see at least a solid two-year income history for self-employed borrowers for just about any type of business.

Some borrowers have a full-time income made up of their main line of work (40 hours per week) as their core source of income. And the same borrower may also have supplemental income from part-time work that is on or off every few weeks or months such as part-time house painting or rideshare driving. Even if the borrower applicant has been painting homes on the side for the past 20 years, the inconsistent income that may vary between zero dollars per month up to \$2,000 per month may not be allowed as a supplemental income source because the income is earned so sporadically. In fact, the underwriter may not give any income credit whatsoever for the borrower applicant's house painting or rideshare-driving job when analyzing the loan request.

Many wage earners have one or more **secondary income sources** besides their primary job income that *can* be analyzed to determine if they can be used in the mortgage underwriting process.

These additional income sources may include:

- Pension
- Social Security
- Child support
- Alimony or spousal support
- Public assistance programs (welfare or food stamps)

For divorced mortgage applicants, the lender may request a copy of the final divorce decree and copies of past child support and spousal support payments before they will consider whether the additional income can be used to qualify. If there is only a year or so left on future child and spousal support payments, the lender may deny the additional income sources because they will soon go back down to zero. If one or more of the children is near the age of 18 or about to graduate from high school, the child- support payments may soon go to zero as well and the underwriter will likely exclude this income from the borrower's application.

Chapter Nine Summary

- The actions of a central bank such as the Federal Reserve or some other type of financial regulatory board that directly impacts the rate of growth of the money supply is responsible for the formulation of the nation's **monetary policy**.
- When the Fed wants to speed up or boost the economy, it will take **expansionary** actions such as lowering short-term interest rates and improving access to funds for consumers and banks.
- During economic times when inflation is too high and the Fed wants to slow down the economy, it takes a **contractionary** action by increasing rates and decreasing access to capital for consumers and banks.

- The Fed's decisions to buy or sell government securities in the open market as a way to expand or contract the national money supply is known as the **open market operations**. More money will be added to the economy after the Fed buys securities. Less money will be available when the Fed sells securities.
- The **Fed Funds Rate** is the rate at which banks lend money to one another on an overnight basis. The **Discount Rate** is the minimum rate set by the Federal Reserve for lending to other banks.
- The **primary mortgage market** (commercial banks, savings banks, life insurance companies) is the main way customers obtain a home loan.
- The **secondary market** consists of both government and private financial agencies or businesses that purchase funded loans from the primary banks. The best known secondary market investors are Fannie Mae, Freddie Mac, and Ginnie Mae.
- California has two regulatory agencies for mortgage brokers: the **California Department of Corporations** (under the governance of The Department of Business Oversight) and the **California Department of Real Estate**.
- A **REIT (Real Estate Investment Trust)** must have at least 100 financially qualified investors. At least 90% of the annual income received from rents or property sales is required to be distributed to each investor.
- The **FHA** insures a portion of a mortgage borrower's loan while the **VA** guarantees a portion of a borrower's mortgage loan as they promise to pay back the losses to the funding lender or mortgage loan service company. Most residential loans funded these days are some type of government-backed loan product with FHA leading the way.

- Lenders may consider the “3 C’s” when determining whether a borrower applicant is creditworthy. **The “3 C’s” consist of: Character (credit history), Capacity (income and assets), and Collateral (property value).**

Chapter Nine Quiz

1. Which agency or group impacts monetary policy the most?
 - A. Federal Reserve
 - B. Congress
 - C. U.S. Treasury
 - D. Consumer demand
2. The period of time when financial actions are taken to stimulate economic growth by easing access to the money supply is _____.
 - A. Inflationary
 - B. Expansionary
 - C. Contractionary
 - D. Disinflationary
3. Monetary policy’s number one fear is _____.
 - A. Expansion
 - B. Contraction
 - C. Inflation
 - D. Demand
4. What was the highest interest rate reached for the Prime Rate?
 - A. 21.5%
 - B. 19.5%
 - C. 17.5%
 - D. 15%

5. What was the interest rate difference between the highest and lowest Prime Rate between 1980 and 2017?
- A. 9%
 - B. 10.5%
 - C. 14%
 - D. 18%
6. When the Federal Reserve sells securities, what will likely happen to the national supply of money?
- A. Increases capital access
 - B. Decreases the money supply
 - C. Raises interest rates
 - D. No impact at all
7. The Fed's strategies to use open market operations include ____.
- A. Changing short-term rates
 - B. Buying government securities
 - C. Selling government securities
 - D. All of the above
8. How many times per year does the Federal Reserve usually meet?
- A. 4
 - B. 6
 - C. 8
 - D. 12
9. The minimum rate set by the Fed for lending funds to other banks is ____.
- A. Federal Funds Rate
 - B. Prime Rate
 - C. HELOC Rate
 - D. Discount Rate

10. Government spending and taxation strategies that influence the overall economy are referred to as a(n) ____.
- A. Monetary policy
 - B. Inflationary policy
 - C. Fiscal policy
 - D. Expansionary policy
11. Community banks, savings banks, and credit unions are in the ____.
- A. Borrower's neighborhood
 - B. Borrower's city
 - C. Primary mortgage market
 - D. Secondary mortgage market
12. What federal act established FHA?
- A. National Housing Act of 1934
 - B. Fair Housing Act
 - C. National Secondary Markets Act
 - D. National Banking & Supervision Act

Answer Key:

1. A	6. B	11. C
2. B	7. D	12. A
3. C	8. C	
4. A	9. D	
5. D	10. C	

CHAPTER 10

CREDIT AND MORTGAGES

Overview

The real estate industry is built on the access to credit and capital. Without access to money to buy, build, and sell properties, there would be relatively few real estate sales or leasing transactions today. This chapter will cover the earliest origins of the best known credit reporting agencies, how FICO scores help or hurt mortgage borrowers, and the growth of credit cards and other types of consumer debt. Real estate agents should learn about as many creative seller financing options as possible so that they will increase the odds of selling a residential or commercial property as will be discussed in depth in this chapter along with the more conventional mortgage programs, features, and underwriting guidelines that borrowers must meet in order to qualify.

Credit and Financial Access

A consumer's credit history will determine what kind of loans they will qualify for in the near term. The better one's credit history is at the time of filling out their mortgage loan or credit card application, the better the rates and fees will be for the applicant.

The access to mortgage money is the single most important driving force behind whether a real estate market cycle moves in either a positive or negative direction. For much of the 20th century, the most popular type of mortgage loan product available to consumers who were interested in buying their first home was a loan offered by a loan officer at the local community bank, commercial bank, or savings and loan ("savings bank"). A high percentage of the loan products offered by these banks were some form of government-backed or insured loan products that a mortgage

applicant with a decent credit history and a full-time job could qualify for with 5% to 20% down payments.

As time moved forward in the 20th century and computer information systems became more powerful and shareable, the history of a mortgage loan applicant's credit report became almost as important as the consumer's income and asset histories. In many ways, the increasing number of credit reports obtained over the past several decades has been a major catalyst of the boom and bust cycles that were experienced by the financial and housing markets across the nation and especially here in California. "Money makes the world go 'round" as the old saying goes, but credit also helps to energize it in a positive or negative way.

The History of Credit Reporting Companies

Depending upon the consumer, his or her credit report can be the most important factor that allows him or her to qualify for a new credit card, automobile loan, or home mortgage. But a negative credit profile can be the main reason why the credit applicant's loan request is denied.

A consumer applicant who consistently pays his or her bills on time to maintain a solid credit history is one who is beloved by credit issuers. In fact, the creditworthy consumer will probably continue to receive unsolicited credit-card offers on an almost monthly basis, regardless of whether their income levels are sufficient enough to cover all of their debt. As long as the consumer makes their minimum monthly payments and the debt compounds each year at 18% or more, the credit card issuers are happy.

Many Americans today spend more money than they take home as net income. Lenders want to be paid back at some point in the future after they have received years' worth of interest payments and other fees. Many of these lenders believe that the best way to predict how someone will act in the future is to review their past credit record.

Let's take a look below at the history of the three main credit-reporting agencies or bureaus to better understand how their evolution, growth, and ongoing sophistication can either help or harm someone who is trying to qualify for some type of new credit.

Experian

In 1826, a group of London merchants called the Manchester Guardian Society first began sharing information of the customers who failed to pay their debts. It was really more of an act of self-preservation for these merchants in London to start sharing their customers' credit and debt payment histories, so the merchants could sell more to the customers who would keep paying their bills on time and avoid those who did not pay. Seventy years or so later in America in 1897, a lawyer in Dallas began to compile a list of consumers who were considered either good or bad credit risks after interviewing several local merchants in the area prior to pooling all of their information together.

In the 1960's, two aerospace engineers at TRW (a defense and electronics company) thought that the national and global society would be moving away from cash towards credit on a much wider basis. These engineers at TRW used their powerful computer information systems and backgrounds as analytical engineering professionals to create a new consumer credit division. In the 1970's, TRW launched a small business database system that would tie into the consumer credit reporting systems for individuals. By the mid-1980's, TRW had compiled the fairly-detailed credit histories of more than 90 million Americans.

TRW's credit reporting business was far from perfect in its early years of operation. For example, an investigator hired by TRW in 1991 had erroneously reported that 1,400 residents in a small town in Vermont had not paid their property taxes on time. The delinquent tax notices that began popping up on these Vermont residents' credit reports had adversely impacted their creditworthiness up until TRW learned of the

mistake and corrected it.

Several other misreporting disasters were uncovered after investigations took place both from within TRW as well as from outside companies that were researching the accuracy of TRW's credit-reporting systems. Unhappy customers began filing civil complaints or lawsuits against TRW for their false reports that were harming people's ability to borrow funds and damaging their personal and business reputations. After many lawsuits were filed and numerous articles were written about TRW's inaccurate reports and shoddy customer service, TRW worked hard to implement changes to improve its techniques and its overall customer-service skills.

What was frustrating for many consumers back in the early years of TRW's existence was that there was an annual \$30 fee that was required to view a consumer's own credit report. It was understandable that so many customers were upset that they had to pay that fee each year to view a credit report that had a lot of mistakes that were hurting the consumer's chances of qualifying for new credit. In later years, all of the major credit reporting bureaus would be required to offer a free copy of a credit report, in accordance with the passage of the **Fair Credit Reporting Act**.

Fair Credit Reporting Act (FCRA), 15 U.S. Code § 1681b - Permissible purposes of consumer reports

(a) In general Subject to subsection (c), any consumer reporting agency may furnish a consumer report under the following circumstances and no other:

(1) In response to the order of a court having jurisdiction to issue such an order, or a subpoena issued in connection with proceedings before a Federal grand jury.

(2) In accordance with the written instructions of the consumer to whom it relates.

(3) *To a person which it has reason to believe—*

(A) *intends to use the information in connection with a credit transaction involving the consumer on whom the information is to be furnished and involving the extension of credit to, or review or collection of an account of, the consumer; or*

(B) *intends to use the information for employment purposes; or*

(C) *intends to use the information in connection with the underwriting of insurance involving the consumer; or*

(D) *intends to use the information in connection with a determination of the consumer's eligibility for a license or other benefit granted by a governmental instrumentality required by law to consider an applicant's financial responsibility or status; or*

(E) *intends to use the information, as a potential investor or servicer, or current insurer, in connection with a valuation of, or an assessment of the credit or prepayment risks associated with, an existing credit obligation; or*

(F) *otherwise has a legitimate business need for the information—*

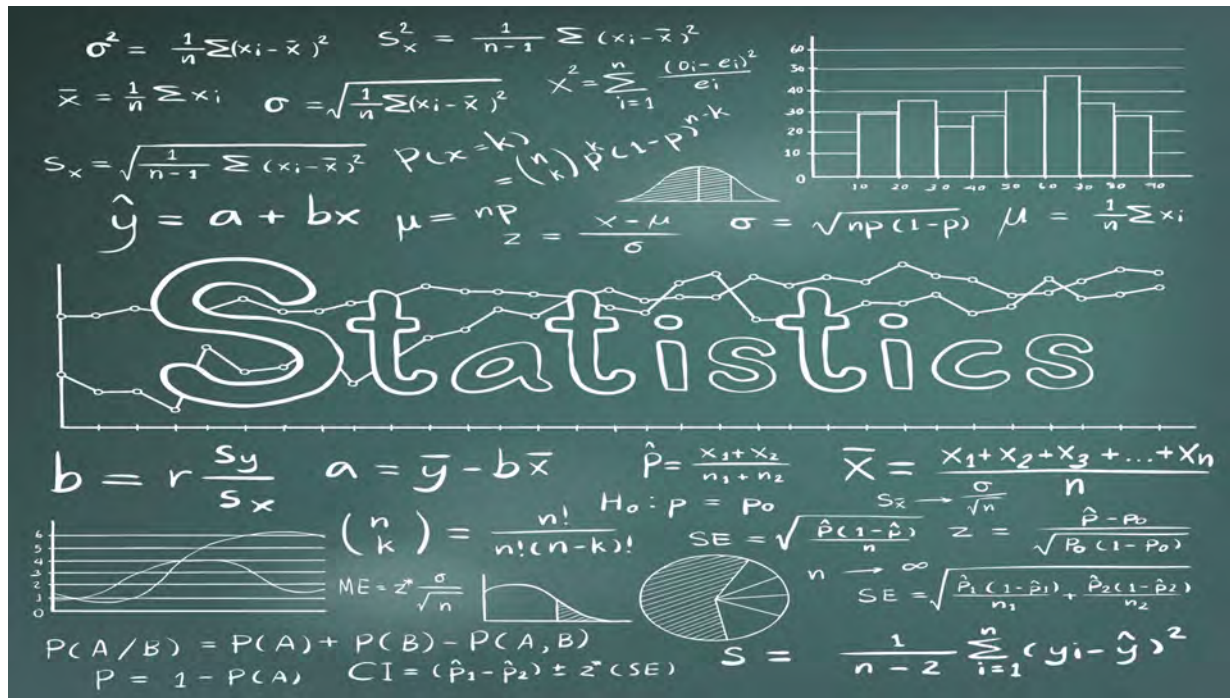
(i) *in connection with a business transaction that is initiated by the consumer; or*

(ii) *to review an account to determine whether the consumer continues to meet the terms of the account.*

(G) *executive departments and agencies in connection with the issuance of government-sponsored individually-billed travel charge cards.”*

From TRW to Experian

In 1996, the consumer credit reporting division of TRW that was named *TRW Information Systems & Services* moved to separate itself from their Cleveland, Ohio-based parent company as it spun off in a private equity deal that was valued at over \$1.1 billion dollars. The alleged primary money source and new business partner that assisted with this private buyout deal was the largest credit reporting company in the United Kingdom, called the *CCN Group, Ltd.*



Equifax

Equifax is a multi-billion-dollar credit-reporting conglomerate that first opened for business in a small grocery store in Tennessee in 1898. The owner of the store began compiling a list of customers that he considered the most creditworthy and reliable before later selling this list of financially stable customers to other business owners nearby for a fee. Amazingly, the business owners that were approached to buy the list of creditworthy customers were very interested. Without customers who had

cash or could pay off their store credit on a timely basis, the neighboring stores would not stay in business very long.

As word spread around Tennessee and other regions, the demand compounded and grew from fellow business owners in search of reliable customers who had access to cash and paid back their store credit. New branches opened around the nation, and the company formally incorporated in 1913 as **Retail Credit, Inc.**, the same year the Federal Reserve opened its doors. Just seven years later in 1920, Retail Credit, Inc. had 37 branches throughout North America.

By the mid-1960's, the consumer data that was collected and stored on paper index cards was transferred to electronic data storage. Outside investigators were hired as a matter of daily business practice for the Retail Credit firm. Many of the strategies the private investigators used were considered fraudulent, unethical, and a violation of people's civil rights and right to privacy. After the passage of the Fair Credit Reporting Act in 1971, Retail Credit was faced with many consumer lawsuits and investigations by the Federal Trade Commission over the next few years. As a result, Retail Credit had to change its strategies for obtaining consumer credit information without the misrepresentations.

The Retail Credit name was changed to Equifax in 1979. Equifax is a derivative of the phrase "*equitable factual information*." This credit reporting firm had data on 150 million consumers by 1986. A year later, Equifax operated in all 50 states nationwide. In more recent years, Equifax has worked with much of the global audience as they generate over 150 billion credit-score updates every month.

The Equifax credit agency has used its credit data less and less for direct marketing purposes, and more for screening customers for credit cards, automobile loans, and home mortgages. Due to so much false information, identity theft, and consumer fraud around the world today, Equifax and the other agencies have strived to improve their credit reporting data systems. This is partly to avoid lawsuits from unhappy

customers who typically make claims that allege violations of the Fair Credit Reporting Act and other consumer and civil rights laws.

TransUnion

Just like Experian (formerly TRW), TransUnion began as a company whose main business was not the gathering and compilation of credit data, but more as a debt collector. Since credit and debt were essentially “two sides of the same coin,” the movement from the debt to the credit side seemed like a natural transition.

In 1968, the Union Tank Car Company, a railcar leasing business, created TransUnion as its main parent holding company. One year later in 1969, the group acquired the Credit Bureau of Cook County (CBCC) in the Chicago area. The CBCC had overseen a gigantic credit history library that consisted of over 3.6 million card files in 400 separate seven-drawer filing cabinets.

Shortly after the CBCC purchase, TransUnion became the first company in the credit reporting industry to replace old, outdated card file data with automated tape-to-disc transfer data. The computer modernization of the printed card files drastically reduced the time and cost associated with updating and maintaining consumer files. Equifax followed up with the first online information storage and retrieval data processing system that provided perhaps the fastest response times for consumer credit information in the nation.

By 1988, TransUnion had full coverage in the U.S. by maintaining and updating information on almost every market-active consumer. In 2002, TransUnion acquired TrueCredit.com and became one of the most influential direct-to-consumer marketing companies in the world. By 2015, TransUnion was providing consumer information in at least 33 countries.

Which credit reporting system was established first?

How FICO Took Control of Credit

These days, consumers are more likely to ask about their “FICO score” than their TRW/Experian, Equifax, or TransUnion score, even though these three credit reporting companies all play a major role in the overall determination of a consumer’s latest credit score. To best understand how FICO impacts the mortgage markets, we must first take a look back at how FICO was founded and how it evolved.

FICO opened its doors as the Fair, Isaac and Company in San Jose, California in 1956. It was formed as a data analytics company that primarily focused on offering various types of credit reporting services. The name of the company originates from the two main company founders named Bill Fair and Earl Isaac. The partners’ original intent was to offer consumers and businesses some type of a credit-risk model with a score.

All FICO scores today range from a low of 300 to a high of 850. A score of 300 would be considered the lowest or worst credit score possible, while a score of 850 would be ranked as the highest or best credit risk. A FICO credit score compilation can quickly allow lenders to evaluate whether a consumer or credit applicant is worthy of being offered credit.

The FICO score summarizes credit risk, based upon a snapshot of a person’s credit report that usually has updated information from the three major credit bureaus (Experian, Equifax, and TransUnion). As many people who have obtained their full credit reports may know, the three main credit-reporting agencies do not share or report the same exact information. The FICO snapshot offers a detailed analysis in a timely manner that lenders can understand better as a number instead of sitting down to review someone’s credit history dating back years or decades as reflected in reports from the three agencies.

A borrower's debt-to-income ratio is *not* included on a FICO report. This is because the credit agencies do *not* normally know how much a consumer earns each year from work or investment income. The credit agencies would know how to determine debt-to-income ratios only if they had access to tax returns, W2s, or 1099 forms for self-employed investors. Mortgage underwriters obtain that information directly from loan applicants and are able to analyze it when sorting through the credit and loan application files. These days, lenders use their automated underwriting systems to approve or deny a mortgage loan request.

Nationally, the average reported FICO credit score in 2020 was 711. FICO scores and mortgage rates being offered by lenders are inverse to one another just like the movement of a seesaw on a playground. Lower FICO scores lead to higher mortgage rates due to the perceived credit risk; and higher FICO scores are more likely to help consumers find the lowest and most-affordable rates available at the time. A borrower's racial background or ethnic group plays absolutely no role in the calculation of FICO scores.

Let's review below a sample of potential mortgage rates and monthly payments as compared to higher or lower FICO scores to better understand how FICO connects to the mortgage industry and impacts the housing markets.

FICO Score	Interest Rate	Monthly Payment
760 - 850	3.623%	\$1,368
700 - 759	3.845%	\$1,406
680 - 699	4.022%	\$1,436
660 - 679	4.236%	\$1,473
640 - 659	4.666%	\$1,550
620 - 639	5.212%	\$1,650

Credit Cards and Mortgages

The Growth of Credit Cards

In many ways, the growth of the credit reporting agencies, the issuance of credit cards, the availability of hundreds of types of mortgage loans to consumers with credit histories that range from terrible to almost spotless --with or without income and asset verification -- and the booming and busting real estate cycles, all mirror one another since they are truly interrelated and interconnected. Without the creation of sophisticated and computerized credit reports, lenders would not know to whom they should offer credit cards, automobile loans, or home mortgage loans these days.

Some borrowers may literally have fifty or more delinquencies in their credit profile due to legitimate reasons (e.g., divorce, medical bills, loss of job, bankruptcy) and sometimes unknown reasons that should be closely checked (e.g., identity theft, misrepresentation, fraud). That is why it is important for consumers to monitor their credit reports at least once a year. Once credit agencies began compiling consumers' data nationwide while using a uniform standard to measure credit histories with future projections about a person's financial habits or trends, banks could make loan offers to their customers at rates that were based upon their spending and credit repayment histories.



The credit industry almost changed overnight after the issuance of the first credit card in the 20th century. The word “credit” derives from a Latin word “credere” (“to believe” and another variation translates to “I accept”). In 1950, Frank X. McNamara introduced the world to his concept of the **“charge plate”** that his small loan company in New York was offering consumers. The charge plates could be used at local restaurants, department stores, and some hotels in the earliest years of operation.

McNamara called his charge plate (or credit card) *The Diners Club* card, partly because it was originally designed to be accepted at local restaurants. McNamara was able to convince some of the local restaurant owners to accept his charge plate at their restaurant, which he said would stimulate demand for their food from customers who might be running low on cash that week.

Once the customers received their next paycheck from work, they would be able to pay off their credit card bill after dining at the restaurant. Because everyone needed to eat to stay alive, it sounded like a great idea to restaurant owners and consumers alike. Several years later, *American Express* and *Carte Blanche* acquired the *Diners Club* card. With their

much deeper pockets and financial strength, credit cards expanded across the world.



The Evolution of Flexible Mortgage Capital

Lenders need to close loans to stay in business and real estate professionals must sell and lease properties to consistently generate income. Most people today also need to create some form of income and increase the size of their asset base to pay their monthly expenses. Real estate has proven to be the number one source of wealth creation in America over the past 100 years because the equity in a person's residence usually represents the largest share of their overall net worth. As such, easier access to credit and money sources may be beneficial to many different people in many walks of life during periods of time when the economy is moving in a positive direction.

Like with the old childhood game of *Musical Chairs*, real estate investments can be “all fun and games up until the music stops.” With mortgage lending and access to other types of credit, the “music stops” might be a reference to the time periods when lenders turn off their figurative “water spigots” or access to capital for their customers. Mortgage lending has proven to be more like playing with a yo-yo or a

boomerang in that the markets can swing from one extreme to another in a relatively short time span. One day the markets are reaching near-record highs and buyers outnumber sellers. The next week or month, home sellers outnumber buyers and money to lend becomes tighter.

What determines whether a market is swinging from a positive to a negative direction or vice versa is the ease of access to affordable money to buy and sell properties. Even if a seller is quite wealthy, has no mortgage loan on his home, and just wants to sell and take his \$1 million dollar profit with him to the Caribbean, he cannot sell the home to an interested buyer who needs but cannot qualify for a third-party mortgage loan for at least 80% of the purchase price (or \$800,000). Without the loan, the seller is unable to sell his home and the buyer may be forced to continue living in a much smaller home or apartment.

Mortgage loans began to get more creative and flexible in the early 1980's due to a variety of factors. We had wide swinging interest rates that went from single digits (less than 9.99%) up to the high double-digits. Some 30-year mortgages reached 18% and higher rates and the U.S. Prime Rate hit a staggeringly high 21.5% in December 1980. It was home sellers and their advising real estate brokers who were forced to get fairly creative when selling their homes after the more conservative banks nearby were unwilling to adapt to the market conditions and consumer demands.

In 1981, the average 30-year mortgage rate was almost 17% throughout the entire year. In October of that year, the average national mortgage rates peaked at an eye-popping 18.45%. According to the U.S. Census Bureau, the average home cost then was \$82,500. Back in the early 1980's, most borrowers had to come in with at least a 20% down payment to qualify for a loan at 80% LTV. The difference between a mortgage payment at 18.45% and a loan funded in 2017 at a rate closer to 4% would have a huge impact on one's ability to afford the monthly payments.

Had the property owner moved ahead with their purchase in spite of all-

time record high mortgage rates in the fall of 1981, their financial risk would have been rewarded because that same home might be worth \$400,000 to \$1 million plus if located in most parts of California. Interest rates began to rapidly decline as the 1980's came to a close and we moved forward into the 1990's. This same borrower could have refinanced the home mortgage once, twice, or more and cut their monthly payments in half or greater while seeing their home's value double every seven to 10 years.

Seller financing became popular for motivated home sellers and their advising real estate agents as an option to provide their buyers with a much-needed source of affordable mortgage loan options. It was also a way to unlock some of the seller's equity in the property as cash, and a way to create some consistent income streams at relatively high rates of interest that were secured by the seller's home. In the event the buyer later defaulted on the seller-financing option, the seller would just take back the property, lease it out as a rental, or attempt to sell it again at hopefully a much higher price.

Sellers began to consider offering creative financing options to buyers who were unwilling to pay 15% to 18% and higher annual mortgage rates to their local savings banks. These creative financing strategies included:

- Assumable FHA mortgages;
- "Subject to" sales;
- Land Contracts (or Contracts for Deeds); and
- AITD (All-Inclusive Trust Deeds).

Assumable FHA mortgages: There have been tens of millions of FHA mortgage loans funded around the nation dating back to the 1930's. Up until December 1, 1986, most FHA loans could be assumed by the new buyer **without qualification**. Initially, the seller had to fully qualify to obtain the FHA loan at the time of his purchase. However, he could later sell the home to a new buyer who would bring in enough cash to close prior to formally assuming the FHA mortgage loan without providing the

existing lender with any sort of financial documentation. The assumption was really more of a “name change” than a loan application process.

The seller might offer the buyer two options to purchase and assume the FHA mortgage, depending upon the buyer’s access to cash and the seller’s willingness to carry some equity as a second mortgage behind the FHA loan. Some examples follow:

Option #1: The sales price is \$80,000, and the existing first loan with the FHA is \$75,000. The buyer brings in \$5,000 cash to close, assumes the first mortgage, and the buyer and seller split the closing costs 50/50. The seller might need a few thousand dollars out of this cash to pay any real estate agent his or her commission for handling the transaction .

Sales Price: \$80,000

FHA First Loan: \$75,000

Cash to Close: \$5,000

Option #2: The sales price is \$85,000, and the property has the same \$75,000 loan with the FHA. The buyer has \$5,000 cash to close, but he still needs an extra \$5,000 to be carried by the seller in the form of a second mortgage. The seller agrees to offer the buyer a second mortgage in the amount of \$5,000 that is payable at a rate of 12% (interest only) for the next 3 years. At the end of the three-year time period, the buyer would have to either sell the home to pay off the seller, refinance the property and pay off the existing FHA first mortgage and the seller’s second mortgage, or come up with additional cash somehow to pay off the \$5,000 second mortgage note. In this example, the seller would be justified in selling the property at a higher price due to the risk that he is taking by not demanding a full \$10,000 cash down payment option instead.

Sales Price: \$85,000

FHA First Loan: \$75,000

Cash to Close: \$5,000

Seller's Second Mortgage: \$5,000 (12% interest rate)

“Subject to” sales: Some sellers have minimal to no equity in their home and are on the verge of defaulting on their mortgage payment. These sellers might consider selling their property to a buyer who has just enough cash to give the seller some “walking away” money as well as funds to pay one or two agents involved in the transaction. The seller signs over a grant deed conveying his interests in the property to the buyer concurrently with the placement of funds into escrow (e.g., the buyer may bring in \$10,000 or so as his consideration to buy the home). Once the grant deed ownership interests are conveyed from the seller to the buyer upon recording with the county clerk, the title is transferred to the buyer, who then continues to make the same monthly mortgage payments to the seller's original lender.

There is no formal loan assumption or qualification process for a buyer who purchases a home “subject to” the seller's existing mortgage. The consideration to purchase the property could be as low as \$10 or any dollar amount above this number that is mutually agreed to by both parties. In theory, most lenders will probably say that they don't like “subject to” transactions and have the right to call the loan as all due and payable upon a deed transfer to a new buyer.

Most mortgage notes contain an “alienation clause” or “acceleration clause” which grants power to lenders to initiate a foreclosure action shortly after the violations of a condition in the mortgage note such as transferring title to a new buyer without formal loan assumption. However, most lenders these days are happy to receive consistent monthly payments from anyone due to their record number of defaulted mortgage payments over the past 12 years or so. But it is still a potential risk that must be fully disclosed by the seller and any real estate agent involved in the “subject to” transaction.

Land Contracts (or Contracts for Deed): Land contracts (or contracts for deed) were quite popular in the late 1970's and early 1980's due primarily to the record-high mortgage rates reached during those peak rate years. They are **installment sales contracts** (*"a type of contract with periodic payments"*) offered to buyers with interest-rate options that were lower than most conventional mortgage rates being offered from banks at the time, and they have much easier qualification requirements. As a result, a buyer would most likely prefer the option of an installment sales contract over a conventional purchase loan if given the choice by a motivated seller as long as the buyer was certain that they would receive the recorded grant deed upon the completion of the land contract term.

The installment sales contract (also sometimes called a **"wraparound mortgage"**) includes the sales price, the down payment required, the interest rate, the monthly payment amount, and the term of the loan with or without a **balloon payoff** (one final payment amount that is much higher than any monthly payment) at the end of the term. The land contract also spells out who pays the monthly property taxes, insurance, and any other designated third-party fees over and above the monthly installment sales contract. The seller's recourse (or foreclosure rights) in the event the contract buyer does not pay the required monthly payments or third-party fees, or if the buyer violates some other provision in the contract such as severely damaging the property, will also be included.

Other land contract specifics you should know:

- The seller is called the **vendor** and the buyer is the **vendee**.
- The seller/vendor agrees to finance a portion of the sale for the buyer/vendee.
- The seller/vendor retains legal title and the buyer/vendee receives equitable title.
- An existing mortgage balance that is still in the seller's name will probably be the main debt on the property at the time of sale. The seller may also carry some additional equity that "wraps around" the underlying mortgage debt.

- Upon full payment of the installment sales contract, the seller/vendor will hand the buyer/vendee a signed and recorded grant deed. At this point, the buyer/vendee merges their equitable ownership interests with their newfound legal interests and the seller/vendor no longer has any interests or rights in the property.

A seller in a wraparound mortgage transaction may create some solid monthly cash flow from the difference in interest rates between the underlying bank mortgage and the newly created land contract. Additionally, the seller is likely to sell the property and carry some additional equity at a much higher price than the mortgage amount. If so, the seller will create monthly positive cash flow throughout the entire term. At the end of the land contract, the buyer/vendee will either sell or refinance the land contract and cash out the seller/vendor for the remaining unpaid balance.

A “land contract” is somewhat of a misnomer or a confusing title for an installment sales contract. The name originated in the state of Illinois and other Midwestern states partly because many real estate sales involved the sale of solely land. But an installment sales contract can be structured for almost any type of residential or commercial property, including land with a commercial or residential structure on it.

Let’s take a look below at a home priced at early 1980’s prices for a wraparound mortgage scenario:

Sales Price: \$110,000

Wraparound Mortgage: \$100,000

Down Payment: \$10,000

New Wraparound Interest: 10.25%

Loan Term: 30 year amortization, 5 year balloon (all due and payable)

New Wraparound Monthly Payments: \$896 (excluding taxes and insurance)

Seller's Underlying First Mortgage Terms

1st Loan Amount: \$70,000

Interest Rate: 8%

Loan Term: Originally 30 years (25 years remaining)

Monthly Payments: \$513

The equity difference between the wraparound principal amount is **\$30,000** (\$100,000 - \$70,000) and the monthly payment profit difference is **\$383** per month (\$4,596 per year). The monthly positive cash flow paid out over the entire 60-month or five-year term in the 30/5 land contract would be \$22,980. In addition, the remaining \$30,000 in profit (\$100,000 - \$70,000) that was carried as equity will be paid off to the seller/vendor. Assume that the buyer/vendee is paying the homeowner's insurance and property taxes directly on their own.

The total cash received at the start, during the five-year installment contract sale, and upon final payoff would be:

Down Payment Received:	\$10,000
Monthly Mortgage Profits:	\$22,980
Final Principal Payoff:	<u>\$30,000</u>
Total Profit:	\$62,980

The main risk of a land contract for a seller and any real estate agents assisting back in the late 1970's, early 1980's, or today, is whether or not the seller has true marketable or valid title. A title report should be ordered from a respected title insurance company in the area to confirm that there are no additional liens or encumbrances against the property and that the seller does in fact own the property.

Upon the closing of the installment sales contract, a trusted third party should hold the seller's signed copy of the grant deed to the buyer. At the completion of the installment sales contract terms, the signed grant deed will be recorded by the county clerk to complete the title and vesting change from the seller to the buyer. A title, escrow, accounting, or legal firm may agree to handle the closing and hold the signed grant deed.

Some third parties that handle the closings will also agree to collect the monthly payments from the buyer/vendee prior to concurrently paying the seller's first mortgage payment. This way, both the seller/vendor and buyer/vendee know that all liens against the property (recorded or not) are being paid in full. The third-party payment collection person or company may also issue a 1099 tax form to the seller for any net income received over \$600 per calendar year and a 1098 tax form for potential mortgage interest deduction options for the buyer/vendee. The more automated and organized the payment process is for both parties, the more likely it will be successfully completed.

Sometimes, an unscrupulous or dishonest seller/vendor will collect the monthly payments from the buyer/vendee while not continuing to pay the underlying first mortgage payment still in the seller's name. The outcome might end up being a foreclosure situation where the first lender wipes out both the legal interests held by the seller/vendor and the equitable interests held by the buyer/vendee.

AITD (All-Inclusive Trust Deeds): An All-Inclusive Trust Deed is very similar to a land contract. The main difference is that the signed grant deed that conveys title from the seller to the buyer is recorded at the start of the wraparound mortgage contract. The main risk for the seller is that he or she is willingly giving up his or her legal rights to the property before the buyer has fully paid off the installment sales contract. Most buyers will request an AITD rather than a land contract because the title is transferred to them right away. Should the buyer later default on the

payments, the seller will have the right to foreclose and take back the property just like any other lender.

Newer Seller Financing Regulations

The Dodd-Frank Wall Street Reform and Consumer Protection Act (signed into law on July 21, 2010 by President Barack Obama) made it more challenging to qualify for both conventional and seller-financed properties. While the intent to “protect the consumer by improving financial disclosure methods” might have been sincere, the new law made it more difficult for some buyers and sellers to complete their purchases and sales. Prior to the passage and enactment of Dodd-Frank, there were not many regulations holding back sellers from offering many types of creative seller-financed options to motivated buyers.

Today, it is a bit more challenging for sellers to carry a new first mortgage for free and clear properties or to “wrap” existing mortgages with a land contract or AITD. Sellers can no longer offer a residential mortgage (one-to-four unit) without first making a reasonable and good-faith determination that the buying prospect has the ability to repay the loan. Without looking into whether or not the buyer has sufficient income and debts that are not too overwhelming, the buyer could later actually file a lawsuit against the seller and any real estate agents for providing them with a seller-financed home even after losing the property in foreclosure back to the original seller.

The seller must also meet these additional guidelines before offering seller-financed terms to buyers:

- 1) The seller must not have built the home that is being sold.
- 2) The loan term must be fully amortized with **no balloon payments**. (As discussed earlier, a balloon payment is a final

payment that is much larger than the monthly payments in the sales contract.)

3) The loan must have a fixed interest rate for at least five (5) years before it can convert into an adjustable loan.

4) The loan must also meet other guidelines that were established and enforced by the Federal Reserve Board.

Qualified Mortgages (QM)

There were new regulations that came into effect in 2014 because of the passage of Dodd-Frank and updated Consumer Financial Protection Bureau (CFPB) guidelines that were implemented with the intent to improve financial-disclosure details and reduce costs for consumers. Those regulations were included the **Qualified Mortgage (QM)** loan designation. Lenders must analyze a prospective borrower's ability to repay the loan before offering the mortgage. Should the borrower later default on their loan, the borrower could sue the lender for offering them the loan in the first place if the bank did not follow the most appropriate QM underwriting guidelines.

A QM was not able to be offered to any borrower with a back-end debt-to-income ratio that exceeded 43%. Additionally, the cumulative lender fees that could be charged to a borrower were limited to a total 3% rate fee cap (loan fees, title, appraisal, etc.) as compared with the proposed mortgage loan amount. For a \$100,000 loan, the 3% rate fee cap would be limited to \$3,000 or less. For smaller loan amounts under \$100,000, this would be much more challenging for lenders to make any sort of real profit, especially for loans under \$50,000 (3% total fee cap = \$1,500).

After QMs were offered to the general public, most of these loans were funded by some of the biggest banks, such as Bank of America, JPMorgan Chase, and Wells Fargo & Co., partly because they had the large staffs available to handle all of the required paperwork in a relatively short

period of time. The financial risks for lenders that offered a QM that might later go into default were too much for some small to mid-size lenders that did not have the financial strength to afford having to buy back the defaulted mortgage from secondary-market investors or face lawsuits from the borrowers themselves who lost the home to foreclosure.

A QM is considered a solid A credit loan risk. The loan is salable in the secondary markets to investors such as Fannie Mae. As a result, the mortgage rates for a QM are usually close to the best 30-year rates available for borrowers.

Residential Loan Features

A mortgage loan will include basic features such as the mortgage principal amount (the amount being borrowed), the interest rate (fixed, adjustable, or some hybrid of both), the loan term and type of amortization schedule, a loan-to-value ratio (LTV), loan fees, and an allowance for secondary financing options behind the first mortgage in some cases.

The property is the main collateral for the loan. Sometimes, lenders will place a loan against two or more properties (land, homes, or commercial properties) for better collateral protection at a much lower loan-to-value ratio. This type of loan secured by two or more properties is called a **blanket loan**. The loan will probably include a **partial release clause** for early payoffs of one or more properties after the borrower continues to pay back the lender.



The **repayment period** for a loan is, of course, the number of years that a borrower has to repay the loan. It is more likely to be referred to as the **loan term**. Most residential mortgage loans have loan terms that last for 30 years (360 months). But there are some lenders who will offer shorter loan term options over 15 or 20 years.

The longer loan terms offer lower mortgage payment options for borrowers as listed below:

<u>Loan Amount</u>	<u>Interest Rate</u>	<u>Loan Term</u>	<u>Payment</u>
\$500,000	4%	30 years	\$2,387/mo.
\$500,000	4%	20 years	\$3,029/mo.
\$500,000	4%	15 years	\$3,698/mo.

The positive benefit for mortgage borrowers who select the most popular 30-year mortgage loan option is that it offers the lowest monthly payments. The main negative associated with the longer loan term selection is that the borrower will pay much more interest over a much longer period of time. With a 30-year mortgage, the first seven (7) years of

payments made to the lender do not usually pay off much of the original mortgage principal amount. Most of the payment is for interest. It is only after the first seven years that the loan balance begins to pay down at a faster pace. Most borrowers remain in their mortgages and homes for less than seven years because they either refinance the mortgage amount or sell the property.

Most lenders will accept voluntary bi-weekly payments made by the borrower in which they send in two half payments each month or they pay an extra mortgage payment or two each year and they ask the lender to apply it towards principal reduction. This way, the 30-year loan may pay off in 15, 17, or 20 years even though the original loan term was for 30 years.

One of the most requested mortgage-loan terms selected by owners and buyers during the peak of the subprime mortgage and Alt-A (“alternative A credit” - akin to a B grade rating because of lower FICO scores and less income verification) markets between the late 1990’s and 2007 was the loan term that was fully amortized over 40 years. The 40-year mortgage was usually offered only for loans that were adjustable during all or most of the loan term.

Sometimes, the starting payment rates for **“negative amortization”** loans were as low as 1% to 1.25% with both 40 and 30-year loan terms. A negative amortization loan is one with a payment structure that allows for a scheduled payment to be made by the borrower that is less than the interest charge on the loan. When that happens, deferred interest is created. For higher priced properties in California with mortgage loan amounts of \$500,000, \$800,000, \$1,000,000, or up to \$5,000,000, these 40-year loan terms with incredibly low start rates were almost 200% to 300% lower than the best 30-year fixed mortgage payment at the time. But in recent years, this type of loan has been deemed illegal for most lenders nationwide, so it is rarely offered these days.

The downside risk with a negative amortization loan was that the loan

would later **“recast”** (or “reset”) once the original principal amount grew in size that was 110% to 115% higher than the starting balance if the borrower only paid their monthly minimum payment out of three or four monthly payment options or choices offered on their monthly statement. The monthly payment options may have included:

Payment Option #1: Minimum payments based on a 1% start rate and 40-year term. The minimum payment is lower than the true note rate (floating index rate plus a fixed margin rate: a 5.25% index rate + 2.5% margin = 7.75 note rate)

Payment Option #2: Interest only payments that are based on the starting 7.75% interest rate that may increase or decrease at a later date, depending upon future market trends. The margin rate at 2.5% is fixed and never changes. The original mortgage principal amount would neither increase nor decrease in size over the entire 30 or 40-year mortgage term if the borrower always paid the interest-only option.

Payment Option #3: The borrower pays the fully amortizing payment rate that includes both some principal payments along with all of the interest payments over the period of 40 years. The loan will be fully paid off in 40 years if the borrower paid option #3 for the entire 40-year term.

Payment Option #4: The borrower pays some principal and all of the required interest over 30 years. This is the highest payment option out of all three loans. The borrower will pay much less interest over the life of the loan by choosing the 30-year option instead of the 40-year loan term.

Interest Rates: Most borrowers are focused more on the latest fixed interest rate option available today than the loan term. Both the loan term and the rate will determine what the monthly mortgage payment will be for the borrower. While home prices have been reaching record highs in many parts of California, the low interest rates that lenders are offering are allowing more borrowers to qualify for mortgage loans with higher balances.

Let's take a look below at the average 30-year fixed rate mortgage in the month of January over the past 20 years to better understand how far rates have dropped from their past peak highs:

<u>Year (January)</u>	<u>Fixed Rate</u>
2002	7.00%
2003	5.92%
2004	5.71%
2005	5.71%
2006	6.15%
2007	6.22%
2008	5.76%
2009	5.05%
2010	5.03%
2011	4.76%
2012	3.92%
2013	3.41%
2014	4.43%
2015	3.67%
2016	3.87%
2017	4.15%
2018	4.03%
2019	4.46%
2020	3.62%
2021	2.86%

* Source: *Freddie Mac*

Loan-to-Value Ratio: The loan-to-value ratio (LTV) is a loan formula that takes into account the relationship between the amount of the proposed new mortgage loan amount and the current market value or purchase price for the subject property being financed. If a buyer is purchasing a \$400,000 home and has \$80,000 cash available for the down payment,

he will be seeking a \$320,000 loan which represents 80% loan-to-value.

Loans with an LTV over 80% will have an extra monthly mortgage insurance premium (MIP) or private mortgage insurance (PMI) to pay because the borrower is perceived to have a higher risk of default. Loans with an LTV ratio of 80% or below will not be required to pay for MIP or PMI because the borrowers are considered lower risk. Some lenders will charge slightly higher mortgage interest rates in addition to the monthly mortgage insurance premiums when the LTV is higher than 80% due to the loan's higher risk of default. The lowest available mortgage rates are offered to borrowers when the LTV range is under 80%. Some lenders will offer even lower rates if the LTV range is under 50%.

VA loans still offer the lowest down payment options (zero or nothing down) out of any residential mortgage loan offered today. Some lenders will offer concurrent second mortgage loans at higher rates behind their own first mortgage loans, or they may allow the seller to carry some equity as a second mortgage behind the seller's new first mortgage allowing the borrower to come in with only 5% or 10% cash down for the purchase. The second loan may also have a CLTV (combined loan-to-value) ratio when factoring it in with the first mortgage loan ahead of it.

An example of an 80/10/10 mortgage loan combination for a \$400,000 purchase deal is as follows:

First mortgage loan: \$320,000 loan amount, 5% rate, 30-year term, 80% LTV, and a \$1,717 monthly payment

Second mortgage loan: \$40,000 loan amount, 8% rate, 15-year term, 10% LTV (90% CLTV), and a \$382 monthly payment

Cash down: \$40,000

The borrower's combined first and second mortgage payments that will be due each month will be \$2,099 (\$1,717 + \$382). The first loan is considered the **primary loan** and the second mortgage is the **secondary**

financing. The first to file their lien usually has priority over any liens filed later, especially in foreclosure situations. Because second, third, and fourth lien position mortgages behind a first loan have more risk of default and getting completely wiped out at a foreclosure auction, these loans usually are priced at rates much higher than first mortgages and with shorter loan terms. A second mortgage may also be referred to as a **junior trust deed**.

Adjustable Rate Loans

The interest rate for a fixed rate loan is easy to understand because the rate will never change during the life of the mortgage. An adjustable mortgage loan choice is a bit more confusing because there are several more components in an **adjustable rate mortgage (ARM)** than in most other types of loans.

The **basic features of an adjustable-rate mortgage loan** include:

Note Rate: The ARM's initial interest rate. The promissory note (the "IOU" for the mortgage debt) that is not recorded along with the trust deed (or grant deed) contains the rate, term, and payments. The term "note rate" is a reference to the loan terms that are included in the promissory note.

Index: This is the main part of the ARM that can adjust upward or downward depending upon which index the mortgage is tied to at the time the loan is funded. The index rates may vary from .09% to 3.25% for some indexes today. Some of the most common types of indexes used in California and other western states for residential or commercial mortgage loans include:

- The 11th District Cost of Funds (COFI)
- 12-Month Treasury Average (MTA or MAT)
- London Interbank Offered Rate (LIBOR)
- Cost of Savings Index (COSI)
- Certificate of Deposit Indexes (CODI)

- WSJ Prime Rate

Margin: The difference between the note rate and the index rate is the margin. The margin is how the lender makes the bulk of their profit. The lender will set a fixed amount for the margin that never changes during the life of the loan. Riskier loans will have higher margin rates and more traditional loans will likely have lower margins. The typical fixed margin rate is somewhere between .075% and 2.0%. If the underlying index is currently at 2.5% and the margin is 1.0%%, the true note rate will be 3.5%.

Rate adjustment frequency: An index can fluctuate once a month, or every three months, every six months, or once a year as determined by the rate adjustment period selected for the mortgage loan. Most adjustable-rate mortgages will adjust every year. During years when rates are headed downward, the borrower's new payments will also be lower after the index adjusts. And of course, when rates are headed upward, the borrower's new payments will be higher.

Fixed/Adjustable Hybrid Loan: Some residential and commercial loans will offer the borrower a combination of both a fixed and adjustable-rate option during the same loan term. The rates will begin at a fixed rate for a specific time period such as 3, 5, 7, or 10 years prior to later converting to an adjustable-rate mortgage. A 3/1 hybrid loan, for example, would be at a fixed rate for three years, and then convert to an adjustable loan for the remainder.

Lifetime Cap: An adjustable-rate mortgage will usually have a lifetime rate cap or ceiling amount limit that is included in the original promissory note. The ceiling rate might be 5% or 6% higher than the initial starting rate for the mortgage. Even if interest rates shoot skyward to 20% or more as they did during a few months in 1980 and 1981, the total note rate cannot exceed 5% or 6% higher than the start rate. If the loan had a start rate of 3.22% for a loan after adding the index to the margin rate, the

maximum ceiling rate would be 8.22% if it had a 5% ceiling rate cap or 9.22% if there was a 6% ceiling rate cap.

Commercial Loans: Most types of loans for commercial properties (5-plus-unit apartment buildings, offices, retail centers, industrial) are both fixed and adjustable. The typical commercial loan term is fixed for 5, 7, 10, or 15 years before later converting to an adjustable rate that is tied to an underlying index like the LIBOR or MTA rates. The bank's mortgage underwriters will closely analyze both the borrower (individual or entity such as an LLC or corporation) as much as the subject property.

Commercial mortgage loans are generally much larger than residential loans. Some lenders will offer only commercial loans that begin with loan amounts of \$500,000 or more. There is so much more work involved in the underwriting of a commercial loan that lenders need a decent loan size to make it worthwhile and profitable for them.

Due to the higher risk of larger commercial loans, most loan-to-value ranges are close to a maximum range of 65% to 70%. A lender may offer the capital in the form of debt, equity, mezzanine (a fancy term for a large second mortgage), a swing loan (a loan placed on one property owned or being sold to acquire a new property), a bridge loan (financing used to complete projects under construction) a gap loan (a combination of a swing and bridge loan), a participation mortgage (where the lender shares in the future income and equity gains), or some combination of these profit sharing options.

For the individual borrower, the underwriter will factor in his or her proposed **debt-to-income** ratios and the **debt service coverage ratio (DSCR)** for the property. The debt-to-income ratio (DTI) is the amount of monthly overall debt expenses for the borrowers divided by their gross income, as noted earlier in this course (e.g., \$3,000 per month in total monthly expenses that is divided by \$10,000 in income = 30% DTI ratio). Most lenders want borrowers who have relatively low DTI ratios (under 40%) while some lenders may consider higher debt-to-income ratios of up

to 50%.

The **debt service coverage ratio (DSCR)** takes the commercial property's net operating income and compares it with the proposed new mortgage payment. Most commercial properties generate some type of consistent income. The lender usually wants the income to exceed the monthly mortgage payment by **25% to 45%**. This number for the DSCR is a 1.25 to 1.45 debt service coverage ratio. As we have previously discussed, a property that breaks even with just enough income to cover the mortgage payment would have a 1.0 debt service coverage ratio. Lenders want to make sure that borrowers have sufficient income to make their mortgage payment each month. That is why the DSCR ratio is so important to them when qualifying borrowers.

Chapter Ten Summary

- The three main credit bureaus or agencies are Experian, TransUnion, and Equifax. Their histories go as far back as the late 1800's.
- Most banks and consumers are more interested in their "FICO scores" than their individual credit scores from the three main credit agencies. FICO, which began as "Fair, Isaac and Company in San Jose, California, compiles the reports from the three agencies prior to assigning each borrower a credit score rating somewhere between 300 and 850. The lowest scores are considered the worst credit ratings.
- In 1950, Frank X. McNamara introduced the world to his concept of the "**charge plate**" (the world's first credit card) that his small loan company in New York was offering consumers. The charge plate could be used at local restaurants, department stores, and some

hotels in the earliest years of operation. Today, outstanding unpaid credit card debt exceeds \$1 trillion dollars.

- Flexible and “EZ Doc” mortgage financing options began to evolve as far back as the late 1970’s with **seller-financed mortgage methods** that included: 1) assumable FHA mortgages without qualifications; 2) “Subject to” sales; 3) Land Contracts; and 4) AITD wraparounds.
- The **Dodd-Frank Wall Street Reform and Consumer Protection Act** (signed into law on July 21, 2010 by President Barack Obama) made it more restrictive for lenders, borrowers, and sellers to finance or qualify for conventional or seller-financed properties. Tougher mortgage underwriting guidelines were imposed such as lower debt-to-income ratios for consumers and modified financial disclosure forms for lenders by way of **TRID** and the **Consumer Financial Protection Bureau**.
- A **Qualified Mortgage (QM)** was not able to be offered to any borrower with a back-end debt-to-income ratio that exceeded 43%. The best conventional rates for the most creditworthy borrowers are considered a QM loan at many banks. Borrowers cannot be charged more than an aggregate 3% amount of fees as compared with the funded loan amount.
- A mortgage loan will include basic features like the mortgage principal amount (the amount being borrowed), the interest rate (fixed, adjustable, or a hybrid of both), the loan term and type of amortization schedule, a loan-to-value ratio (LTV), and loan fees.
- An **adjustable rate mortgage (ARM)** will usually include a note rate, margin, index, a rate adjustment frequency schedule, and a lifetime rate cap. It is the index that can float or adjust upward or downward while the margin (the lender’s profit margin) will remain fixed. The index rate + margin (2% to 3% in most cases) = note rate (or actual rate).

- The **debt service coverage ratio (DSCR)** formula compares a commercial property's net operating income (NOI) with the proposed new mortgage payment. A 1.0 DSCR number is a break-even number when the income just covers the mortgage payment. Most lenders want the income to be 25% to 45% higher than the monthly payments (1.25 to 1.45 DSCR).

Chapter 10 Quiz

1. Which credit reporting system was established first?
 - A. TRW
 - B. Experian
 - C. Equifax
 - D. TransUnion
2. Which FICO score below would be considered by lenders as the best credit risk?
 - A. 425
 - B. 575
 - C. 690
 - D. 780
3. Which item below will not be included on a borrower's FICO report?
 - A. Past addresses
 - B. Employment information
 - C. Past foreclosures
 - D. Debt-to-income ratios

4. What is the national average for a FICO credit score?
- A. 510
 - B. 624
 - C. 711
 - D. 740
5. FHA loans can be assumed without borrower qualification if they were originated prior to ____.
- A. January 1, 1982
 - B. December 1, 1986
 - C. June 30, 1992
 - D. March 1, 1998
6. Which seller-financed sales option does *not* have a recorded grant deed at the start of the transaction?
- A. Land contract
 - B. "Subject to" sale
 - C. AITD
 - D. FHA
7. Which answer below is a type of installment sales contract?
- A. Land contract
 - B. Contract for deed
 - C. AITD
 - D. All of the above
8. Who is the vendor in a land contract?
- A. Buyer
 - B. Seller
 - C. Trustee
 - D. Bank

9. Who retains legal title in a land contract at the start?
- A. Vendee
 - B. Vendor
 - C. Trustee
 - D. Lender
10. After the passage of Dodd-Frank, what is banned for most types of seller-financed sales contracts?
- A. Balloon payoffs
 - B. Wraparounds
 - C. Fixed-rate loans
 - D. AITD transactions
11. Which mortgage loan requires the lowest back-end debt ratios?
- A. FHA
 - B. VA
 - C. Qualified Mortgage
 - D. Private money
12. A loan secured by two or more properties is a(n) ____.
- A. Installment loan
 - B. Blanket loan
 - C. Covered loan
 - D. Reconveyance loan

Answer Key:

1. C	6. A	11. C
2. D	7. D	12. B
3. D	8. B	
4. C	9. B	
5. B	10. A	

CHAPTER 11

ESCROW, TITLE, AND TAXATION

Overview

This chapter is about the part of the real estate profession that is most often the end goal for most real estate agents and principals. All of the hard work that an agent has engaged in for several weeks or months will eventually pay off at the closing of escrow. Readers will learn about the various steps taken in the escrow process, the role that title insurance representatives play, closing costs and net sheets for buyers and sellers, and how gains are taxed or withheld in certain instances.

Escrow and Closing



The word “escrow” originates from the French word *escroue*, which means “roll of writing” or “scroll.” In the earliest years of property ownership, the seller of land or a home would transfer ownership to another party on the fulfillment of certain conditions that were included within the written instructions. The neutral escrow party was required to act unbiased and show no favoritism to either side in the transaction. Once the various steps in the written documents were complete, the third party involved in the escrow transaction would transfer the ownership from the seller to the buyer as instructed.

In more modern times, one or both agents in a sales transaction might refer their principals to a third-party independent escrow company or a title insurance company with an escrow division to handle their clients’ closing process. Sometimes, the buyer or seller will find an escrow office on their own after having worked with one in the past or having been referred by other friends, family, or business associates.

Agents should be cautious when referring their clients to any third party. What if the transaction falls apart due to errors made by the escrow officer? Regardless, no referral fees for the recommendation and new business opportunity are allowed to be paid by an escrow office to any party involved in the deal.

Some good questions that clients and agents may ask when searching for the most effective escrow officer include:

“What is the escrow agent’s experience?”

“What are the escrow company’s fees?”

“Where is the escrow closing handled?”

“How busy is the escrow officer right now?”

“Has the escrow officer ever worked with any principal or agent in

this deal or in other deals in the past? If so, how was the experience?”

“What is the escrow officer’s most realistic time estimate to close?”

“How may the agents and principals best assist the escrow officer in order to close the transaction as soon as possible?”

“How quickly can the escrow officer let the buyer know how much money is needed to close?”

“How soon will the seller have an estimated net sheet that shows how much money the seller will walk away with at the time of closing?”

The word “closing” can have a few different meanings or connotations in real estate. It can refer to the start or the end of a real estate transaction for people involved in the purchase and sale process. To some agents, the phrase “closing a sale” might mean the acceptance of a buyer’s purchase offer when acting as the buyer’s agent or after convincing the seller to accept the offer from the listing agent’s perspective. This description of “closing” at the start of a transaction can be misleading. The most appropriate way to use the word “close” or “closing a sale” with respect to a real estate transaction is when the deal funds and closes escrow .

The vast majority of escrow transactions are closed through the escrow process with either an independent escrow company (as is more common in Southern California) or with the assistance of an escrow company owned by a title insurance company (as is typical in many Northern California transactions). The combination of an escrow and title insurance company is most often used together in almost 100% of all closed transactions in the state, regardless of whether the escrow office is independent or owned by a multi-billion dollar title insurance company, like *First American Title*, *Stewart Title*, or *Chicago Title*.

There will be at least one main **escrow officer** or **escrow agent** (also referred to as the **closing agent**) assigned to each transaction file. The escrow agent owes a fiduciary duty to both the buyer and seller just like a real estate agent would when acting as a dual agent. The escrow agent will hold the money and documents on behalf of both parties while following the written instructions that were initialed and signed by both parties. The escrow agent will transfer title to the property and disburse funds to the designated parties only after all of the written conditions have been met in the escrow process.

An escrow company's main goal is to assist both sides to move from a written purchase offer to a closed transaction by following the clients' listed steps in the paperwork. Both sides become more committed to the deal after signing the initial escrow instructions and after their purchase offers have been mutually agreed to and signed. Once the seller hands over the executed grant deed to the buyer to be held for conveyance after all the escrow conditions have been met, the seller is less likely to change his or her mind and back out of the deal.

The escrow officer must ensure that the buyer moves forward with his or her steps in the process such as: (1) handing over the earnest money deposit, (2) completing any third-party inspections, (3) waiving or accepting dates selected for contingencies, and (4) making sure that the third-party lender provides the loan documents as soon as practicable to meet the scheduled closing guidelines.

An escrow officer may need to act somewhat like a therapist, teacher, spiritual guide, and motivational guru when working with both the buyer and seller as he or she might have to continually nudge the principals to follow through with the deal and meet their steps on a timely basis. Sometimes, one or both agents might panic if there are delays in the escrow process. If so, the escrow officer may also have to spend his or her time offering reassurances and positive thoughts to the agents as well.

Section 17003(a) of the California Financial Code defines escrow as:

“...any transaction in which one person, for the purpose of effecting the sale, transfer, encumbering, or leasing of real or personal property to another person, delivers any written instrument, money, evidence of title to real or personal property, or other thing of value to a third person to be held by that third person until the happening of a specified event or the performance of a prescribed condition, when it is then to be delivered by that third person to a grantee, grantor, promisee, promisor, obligee, obligor, bailee, bailor, or any agent or employee of any of the latter.”

The Supervision of Escrow Companies

An escrow company is a *fiduciary* when working with principals and agents. A fiduciary, once again, is a person or business entity acting with trust, loyalty, good faith, and confidence with all parties in the transaction. Often, the fiduciary handles the collection and disbursement of money, assets, or other things of value from one party to another.

An escrow holder can be a corporation, an attorney, or a real estate broker who acts as an agent in the real estate transaction. All independent escrow companies must be established as a corporation in the state of California when engaging in business that handles the collection and disbursement of funds. Additionally, they are usually required to have sufficient levels of business insurance coverage in the event that any of the clients' funds disappear or are spent without permission by one or both parties involved in the deal.

The California Department of Corporations (DOC), a department formerly within the old California Business, Transportation, and Housing Agency, used to be the main state agency in charge of independent escrow companies. As of July 1, 2013, the Department of Corporations and the Department of Financial Institutions merged and were absorbed by the new California Department of Business Oversight (DBO) agency. Now, the

main governing agency in charge of escrows is referred to more as the **California Division of Corporations** under the supervision of the DBO.

The Division of Corporations now has the responsibility to license, manage, and supervise the following business professions in California:

- Securities brokers and dealers
- Investment advisors
- Financial planners
- Consumer lenders
- Commercial lenders, including mortgage lenders
- Deferred deposit or payday lenders
- Escrow companies
- Certain other fiduciaries

The Division of Corporations is also in charge of regulations for the offer and sale of securities, franchises, and off-exchange commodities. The **Financial Services Division** is in charge of the licensing and regulation for mortgage lenders, other non-bank lenders, mortgage loan servicers, payday or deferred deposit lenders, escrow agents and companies, and other financial services providers.

The **Securities Regulation Division (SRD)** is the primary governing agency responsible for the qualification requirements for the offer and sale of securities, the licensing and regulation of broker-dealers, broker-dealer agents, and investment advisors as pursuant to the **Corporate Securities Law of 1968**. The Securities Regulation Division registers the offer and sale of franchises under the **Franchise Investment Law** and regulates capital access for licenses under the **Capital Access Company Law**.



The Division of Corporations is the main governing agency that supervises these licenses pursuant to the authority granted in the **California Financial Code**, the **California Corporations Code**, and various administration regulations.

Under the California Financial Code, a financial institution that is regulated and licensed by the Division of Corporation is defined here under chapter 1 of the code:

Financial Code - FIN

Division 1. Financial Institutions

Chapter 1. Definitions

“101. If and to the extent that any provision of the Financial Institutions Law is preempted by federal law, the provision does not apply and shall not be enforced. (Amended by Stats. 2013, Ch. 334, Sec. 6. Effective January 1, 2014.)

103. The word “bank” as used in the Financial Institutions Law means any incorporated banking institution that shall have been incorporated to engage in commercial banking business, industrial banking, or trust business. *(Amended by Stats. 2013, Ch. 334, Sec. 7. Effective January 1, 2014.)*

105. Banks are divided into the following classes:

(a) Commercial banks.

(b) Industrial banks.

(c) Trust companies.

(Added by Stats. 2011, Ch. 243, Sec. 2. Effective January 1, 2012.)

107. “Commercial bank” means a corporation organized for the purpose of engaging in the commercial banking business. *(Added by Stats. 2011, Ch. 243, Sec. 2. Effective January 1, 2012.)*

109. “Commercial banking business” includes, but is not limited to, the business of soliciting, receiving, or accepting of money or its equivalent on deposit as a regular business whether the deposit is made subject to check or is evidenced by a certificate of deposit, a passbook, a note, a receipt, or other writing, provided that nothing herein shall apply to or include money or its equivalent left in escrow, or left with an agent pending investment in real estate or securities for, or on account of, his or her principal. In addition, “commercial banking business” means to lend money on the security of real or personal property or without security; to discount or deal in bills, notes, or other commercial paper; to buy and sell for the account of customers, and, if eligible for investment, for its own account, securities, gold and silver bullion, foreign coins, and bills of exchange; and generally to transact a commercial banking business. *(Added by Stats. 2011, Ch. 243, Sec. 2. Effective January 1, 2012.)*

111. “Industrial bank” means a corporation organized for the purpose of engaging in the industrial banking business. *(Added by Stats. 2011, Ch. 243, Sec. 2. Effective January 1, 2012.)*

113. “Industrial banking business” includes the making of loans and acceptance of deposits, including deposits evidenced by investment or thrift certificates, but excluding demand deposits. *(Added by Stats. 2011, Ch. 243, Sec. 2. Effective January 1, 2012.)*

115. “Trust business” means the business of acting as executor, administrator, guardian or conservator of estates, assignee, receiver, depository or trustee under the appointment of any court, or by authority of any law of this or any other state or of the United States, or as trustee for any purpose permitted by law. *(Added by Stats. 2011, Ch. 243, Sec. 2. Effective January 1, 2012.)*

117. “Trust company” means a corporation, industrial bank, or a commercial bank that is authorized to engage in the trust business. *(Added by Stats. 2011, Ch. 243, Sec. 2. Effective January 1, 2012.)*

119. “Bank” or “banks” includes commercial banks, industrial banks, and trust companies unless the context otherwise requires. However, “bank” does not include a savings association or a credit union. *(Added by Stats. 2011, Ch. 243, Sec. 2. Effective January 1, 2012.)*

121. (a) “Office” includes head office, branch office, and any other authorized place of business of a licensee. (b) “Head office” means the principal place of business of a licensee. *(Added by Stats. 2011, Ch. 243, Sec. 2. Effective January 1, 2012.)*

123. “Real property” and “personal property” have the meanings defined in and shall be construed in accordance with Title 1 (commencing with Section 654) of Part 1 of Division 2 of the Civil Code. *(Added by Stats. 2011, Ch. 243, Sec. 2. Effective January 1, 2012.)*

Escrow Steps

An escrow officer is a neutral third party who cannot show any favoritism or preferential treatment to either side in the deal. A buyer or seller is not allowed to call the escrow officer and ask him or her to just make a change to the escrow instructions without first having the other side mutually agree to the modification or amendment request. The escrow agent must follow the steps outlined in the purchase contract, addenda, and disclosure pages that were provided by both sides at the start of the escrow transaction. If the escrow agent deviates in any way from the instructions outlined in the original paperwork, the escrow officer may be in violation of several state codes or regulations.

Escrows may vary in the number of steps that might take place and in the order of those steps. The main steps involved in the process are typically as follows:

Step 1: Select an escrow company that all parties can agree to.

Step 2: The appointed escrow officer or escrow agent introduces him or herself to the buyer, seller, and agents handling the transaction. The escrow agent opens up the escrow after reviewing the signed purchase contracts and creates new instructions that are sent out to all parties for signatures. The escrow agent will ask the buyer to confirm his or her vesting requests for the new ownership interests, such as “sole and separate,” “joint tenancy,” or under a newly formed LLC or corporate entity.

Step 3: The agent creates a master calendar of key dates for the transaction that include the contingency dates for inspections, appraisals, loan approvals and documents, and the scheduled closing date. This calendar is the guiding timeline that the escrow officer, principals, and agents must keep a close eye on during the transaction so that the deal does not fall apart. The escrow officer might send out an updated email with the important calendar dates to each party involved. If

some of these deadlines are at risk for not being met, the escrow agent may consider sending out warnings or alert notices to each party to motivate them to complete the expected next step in the escrow process.

Step 4: The inspection process can either increase or decrease the likelihood of a deal closing on time. A negative third-party inspection report is probably the number one reason why a purchase deal will terminate before the scheduled closing date. The buyer will usually have some type of an earnest money deposit at risk, up to 3% of the purchase price. For many California properties with prices above \$500,000, the good faith deposit might be \$15,000 or so.

Since the buyers do not want to risk losing their escrow fund deposits, they will work closely with their agent and appointed third-party inspectors to ensure that the appraisal, home inspection, and pest control reports are completed before the contingency dates expire. Often, the buyer may have 14, 17, 21, or 30 days to complete the requested inspections and review the corresponding reports.

In situations where the inspections may be delayed by a few days beyond the contingency-date deadline, the buyer and buyer's agent have the right to ask for an extension of this specific deadline. If the seller and listing agent say "no," then the buyer has the option to cancel the escrow and collect the entire earnest money deposit back less any designated expenses to third parties that the buyer had previously approved.

Step 5: Should any of the inspection reports or subsequent principal or agent walkthroughs discover any portions of the home that need to be repaired, the parties decide if and when the repairs will be completed and at whose cost. The parties will then agree and sign updated amendments that were prepared by the escrow agent before any work begins on the property.

Step 6: The escrow agent will order a preliminary title report (or "title prelim") from the title insurance company selected by the principals,

agents, or the escrow officer after all parties have mutually agreed to the title insurance company choice. The title report will identify any existing mortgages, judgments and other liens, easements, and possibly encroachment issues associated with the subject property. The seller and listing agent will then confirm or deny whether the items listed on the title prelim are accurate or not. The escrow officer will later use his or her payoff numbers to update the seller's net sheet.

Step 7: The escrow officer will send out updated **demand-for-payoff** notices to each party listed on the title prelim report that has legal or beneficial rights to receive payoffs at closing after confirming with the seller that the lien numbers are valid. If the seller denies that the lenders or lienholders have any true interests in the subject property, then the seller must provide some sort of evidence that validates that claim.

Step 8: Most buyers will need some type of third-party loan to close escrow on a purchase transaction. Over the dozen or so years, the most popular loan selected to purchase a home has been an FHA mortgage loan. Most FHA borrowers will qualify for loans up to 96.5% of the purchase price of the home. If so, the buyer will be bringing in just 3.5% of their own funds to close (excluding closing costs) or even less should other family members help out with part of the down payment as a gift. If the buyer has already placed 3% with escrow as a form of an earnest money deposit, the escrow agent already has most of the required down payment funds for an average priced home with an FHA mortgage loan.

For conventional and government-backed or insured loans, the appraisal can either make or break the deal. The main collateral offered to the lender in exchange for the requested financing is the property itself. Lenders want to be absolutely certain that the purchase price is not higher than the true market value. Why? The lender's loan-to-value (LTV) range may go from an already high 96.5% to 110% (or "upside down" when the debt exceeds the property value) if the buyer is paying too much for the property. Note that the buyer and seller might later negotiate a new lower price should the appraisal come in much lower than the

purchase price, or the buyer has the right to walk away from the deal if the appraisal report was received well before the expiration of the contingency date.

Step 9: The escrow officer receives back the latest loan-payoff numbers from the seller's mortgage lender and from any other confirmed lienholders. The escrow agent will create a seller's net sheet that includes a list of all proposed closing costs (escrow, title, repairs, documentary transfer tax fees, etc.), prorations for insurance, property taxes, and rents (if applicable should one or more of the units be leased), and lien payoff amounts. The seller will then either agree or disagree with the proposed net sheet. Any cost items in dispute must be rectified or resolved prior to close of escrow. The escrow officer will also require proof of insurance from the buyer's designated insurance provider.

Step 10: Any additional funds that must be placed in escrow over and above the good faith deposit are required to be added to escrow after the loan documents have been ordered. Some loans require 10% to 20% cash down. If so, the buyer will need to add more money to cover the down payment and closing-cost requirements that will be included on the buyer's side of his or her closing sheet prepared by the escrow agent.

Step 11: The lender will deliver to escrow the borrower's loan documents for signing by way of personal delivery, overnight mail, UPS, or Fedex, or via electronic delivery. The borrower will meet with the escrow officer at the officer's desk or in their office conference room to handle the signing of the loan documents (loan "docs"). Should the borrower have any questions regarding the content of the documents, such as the rate, terms, or fees, the escrow agent may be able to answer some of the questions or redirect the borrower back to one of the agents or mortgage brokers involved with the deal. The signed and notarized loan docs will then be sent back as quickly as possible to the lender for funding.

Step 12: The updated versions of the buyer and seller net sheets with their closing costs are given to the principals and agents in the

transaction. The parties will either agree or disagree to the latest numbers and costs provided by the escrow agent. Any financial disputes must be resolved first before the escrow officer can formally close or terminate the transaction.

Step 13: The lender's funding department will provide the mortgage broker or bank's loan officer with an updated list of closing conditions that must be met before the loan can be funded. The list may contain outstanding items that were previously requested or new ones that were noticed after the loan documents were signed. These may include the borrower's proof of sufficient homeowner's insurance, the latest copy of the borrower's paystub or bank statement, and/or written confirmation from escrow that the buyer has placed the required amount of funds in escrow that will cover the estimated down payment and closing costs.

Step 14: The lender funds the loan on the morning of the scheduled closing date or one day before in most transactions. Escrow will be notified that the lender has funded the buyer's loan that may represent 80% or higher of the purchase price. The escrow agent will then confirm and balance the loan amount proceeds with the buyer's deposited fund amounts to make sure that these numbers represent 100% of the purchase price plus closing costs.

Step 15: The final title policy will be issued by the selected title insurance company. The policy will offer various layers of protection for both the seller and buyer, depending upon the policy plan chosen. Lenders will not fund a loan unless they have a clear title policy in place. Why? The lender wants to make certain that their new mortgage loan is in first position after the deal closes escrow and not in second, third, or higher position behind multiple past judgments and tax liens.

Step 16: The escrow agent will send the seller's signed copy of the grant deed to the county clerk for recording. Once the deed is recorded and the title or ownership interests have changed hands from the seller to the buyer, the deal has officially closed escrow.

Step 17: The escrow agent will then balance the numbers on both sides of the closing net sheet before sending them to each side for written confirmation or approval. The escrow officer cannot disburse funds to any party in the transaction without all parties signing off. These fund disbursements may include:

- the seller's net proceeds after paying off his or her loan and other liens, closing costs, and any prorated items;
- refunds back to the buyer due to the overpayment of funds that were originally added to escrow; and
- commission checks that are addressed to the main-designated individual or corporate broker who is in charge of the agent.

Step 18: The escrow agent or the seller hands over the keys to the property to the new owner. The escrow company is paid its fees along with other designated parties to the transaction, such as any third-party inspectors who were not paid upfront as well as the title insurance company. The deal is now officially closed, and hopefully all parties involved felt like it was a positive and successful experience.

Each escrow can have fewer or more steps involved in the process. However, a valid escrow must have at least these main items:

- Sales agreement signed by both the buyer and seller.
- A conditional delivery of funds.
- A conditional delivery of documents.

Closing Costs

The escrow agent needs to balance out both sides of a buyer and seller's net sheets so that the dollar amounts end at zero with an equal number of debits and credits. A closing statement or net sheet is the equivalent of using an accounting ledger or journal to apply credit and debits to each side on a monthly basis. It is also somewhat like the balancing of a checkbook so that the amount of available cash and credits in one's bank account more than cover the amount of checks written for expenses.

Buyer's Net Sheet

The buyer's side of a net sheet will include charges related to any third-party loans, title and escrow fees, third-party inspection reports that were not paid directly by the buyer outside of escrow, repair fees not paid by the seller, and other expenses.

The **purchase price** will be the biggest expense item listed on any buyer's net sheet, of course. For this example, let's say that the purchase price is \$400,000. This number will be the starting point at the top of the buyer's net sheet. The price will later be offset by the buyer's earnest money deposit (listed as a credit for the buyer) and any third-party loan documents that arrive at escrow for the new first mortgage.

The loan details on the buyer's net sheet may include these additional costs:

- Loan origination fees (i.e., 1% to 2% of the loan amount)
- Loan discount fees to buy down the rate (.25% to 1% range)
- Appraisal fees not paid outside of escrow
- Inspection fees not paid outside of escrow
- Credit report fees
- Prepaid mortgage interest (payments are made in arrears)

The buyer will also need to pay his or her share of the escrow, title, and recording costs that are not already credited by the seller's side. It is more likely than not that the buyer and seller will split the costs associated with title and escrow 50/50.

The buyer may then need to pay prorated item charges for the new homeowner's insurance, property taxes, and mortgage payments that will be calculated using 365 calendar days or 360 "banker's days" numbers. **A property tax bill is generally paid twice per year (or bi-annually).** The escrow agent will assign a **credit** and a **debit** on each side of the closing statement depending upon which party owes or is owed the prorated amount.

Proration example: A property is located in an area where a special bond assessment is applied over and above the standard annual 1% property tax rate. For simple math purposes, the extra assessed amount is equal to \$1,000 per year. If we divide \$1,000 by 365 days, it is equal to \$2.729 per day. The property closes escrow on the 15th during a month that has 30 days. The seller had already paid the \$1,000 property tax assessment that goes all the way through to the 30th of the month.

It will be up to the escrow agent to charge the buyer 15 extra days of tax assessment fees and credit the seller for that amount since he already paid it.

$$\$1,000/365 \text{ days} = \$2.739 \text{ per day (15 days} \times \$2.739 = \$41.085)$$

The \$41.085 amount will be listed as a debit for the buyer and as a credit for the seller on the final closing statement.

Costs that are just one-time charges such as title, escrow, and loan fees are called **non-recurring costs** because they are charged only once. Other costs that a buyer will pay that will happen more than one time after closing escrow are called **recurring costs** or recurring charges. A recurring cost for something like a mortgage payment will be paid

monthly while annual homeowner's insurance and property tax costs may be paid twice per year, or, in the case of insurance, even quarterly or monthly.

What will be the buyer's biggest expense listed on their side of the net sheet?



Seller's Net Sheet

The sellers' side of the closing statement will show them how much money they will walk away with at the time of closing. The first and largest item listed on their side of the net sheet will usually be the sales price. From this number, the following items may be deducted in many types of sales transactions:

- Existing mortgage(s) to be paid off
- Mortgage interest still due
- Property tax payments still due

- Loan prepayment penalty fees (if applicable)
- Judgment liens
- Franchise Tax Board or IRS liens
- Mechanic's liens from past contractors or subcontractors
- Title and escrow fees
- Documentary Transfer Tax
- Repair costs or seller credits
- Brokerage commission fees (3% or 6% of sales price)
- Attorney fees
- Recording fees

The Documentary Transfer Tax is assessed at the time of sale for all property transactions in the state of California. The assessment fee can be calculated in one of two ways:

\$1.10 of every \$1,000 that is based upon the property sales price
or
\$0.55 of every \$500 (It is the same calculation formula as used above.)

For a property that sold for \$740,000, for example, the documentary transfer tax fee would be \$814. To arrive at that number, here is the calculation below:

$$\begin{aligned} \$740,000 / \$500 &= \$1,480 \\ \$1,480 \times \$0.55 &= \$814 \end{aligned}$$

The escrow officer will then hand the estimated net proceeds to the seller after listing all of the proposed or actual final expenses that are combined and subtracted from the sales price. The seller might be pleasantly surprised with how high the amount of profit is from the sale. Or, he might be shocked and saddened by the net profit partly because he hadn't realized how high the loan payoff, commission fees, and overall closing costs would be when he first accepted the offer to sell. For real

estate agents, they want their clients to be happy and also want to make sure that there are enough seller funds to pay the commission to one or both brokers.

Amending or Canceling Escrows: Any modification requests made **after** the escrow has been opened are considered **amendments**. Regardless of whether the requested change is verbally approved by both sides and involves something very simple or reasonably priced such as a \$50 credit for a new doorknob, it must still be in writing in the form of an amendment that is signed by both parties. The escrow amendment might consist of only one or two sentences on an escrow document, but it still must be mutually agreed to and signed by both parties to be enforceable.

If the one or both parties wish to cancel the escrow agreement and terminate the deal, then the cancellation instructions must be signed by both parties. Should the parties fail to agree on the disbursement of funds from escrow, the escrow agent will probably be forced to seek legal assistance to settle any dispute because the escrow officer may not take sides.

Title Insurance

Title insurance is required in the vast majority of real estate transactions. This is especially true if there is a third-party lender involved. Buyers should rarely, if ever, waive their right to order a title insurance report when purchasing a property with their own 100% cash due to some potentially serious risk factors. Perhaps, for example, the seller does not actually own the property or the property has undisclosed judgment and tax liens that legally prevent the seller from selling the property in “free and clear” status with no liens of record.

The main purpose of title insurance is to offer some protection against the past history of a subject property as opposed to any occurrence in the future that is usually covered by property insurance companies. The title

policy will confirm whether the seller does in fact have clear ownership without any defects. Without clear ownership interests that are free of liens and other encumbrances, the buyer may not end up with full legal rights to the property even after paying full price to purchase it.



With purchase transactions, the buyer and seller may decide to split the title insurance costs 50/50 or one side might decide to pay for all of the costs. An example of a motivated seller who is willing to pay most or all of the closing costs to a buyer who offers a fair price and a quick close is one of the most common situations where one side pays 100% of the title and/or escrow costs.

The title company will establish its price for the premium fees that are based upon the number of liability issues it protects against. In sales transactions, liability is determined by the sales price of the property being sold or the new proposed loan amount in a refinance transaction.

Because a home is most likely a person's most expensive purchase item, the decision to buy or refinance can be either the best or worst financial

decision depending on whether the property has clear title. Both the buyer and lender in real estate transactions want to make sure that the new buyer will have clear title to the property with no unexpected liens or restrictions that can impact the buyer's right to enjoy, possess, and later resell the property to a new party.

The lender, once again, wants to know that the mortgage lien is really in first lien position and that it has the first right to foreclose and take back the subject property in the event that the borrower later defaults on the mortgage payments. It is the issuance of title insurance that will guarantee both the owner and lender from any losses related to defects in title that may have existed in the public records or upon a close inspection of the property.

One of the worst possible outcomes for a buyer who does not request title insurance is one in which the buyer pays \$100,000 cash for land to a seller who does not even own the property. There are so many real estate scams around the nation, especially with raw land. With the internet, easy access to digital funds like *PayPal*, and a buyer's willingness to purchase things or assets at the touch of a computer keystroke or a Smartphone screen, make life for scammers much easier. In fact, such scams appear to be increasing for both U.S. and foreign residents.

Title insurance protects against potential "clouds on title" (or defects) that can adversely impact the clear ownership of property. It is the title insurance that determines if a property has valid or "marketable" title. The title policy will protect the current owner's interests (also referred to as "equity interests") in the property as well as the new lender's beneficial interests in the property. Some of the most common types of title defects that can affect the clear title or ownership interests in a property include:

- Forged signatures on past grant deeds
- Mistakes such as the wrong address or legal description
- Newly discovered easements or encroachments
- Zoning restrictions that were not previously uncovered

- Contractor and subcontractor liens
- Secret spouses (current or past) who never agreed to sell
- Undisclosed or missing heirs with valid financial interests

The title company will start investigating any potential defects in the property or the owner's title by examining title plants (a database of property information that originates from public records). The title plant data sources may come from deeds, mortgages, divorce decrees, wills, tax records, liens, bail bonds, encumbrances, recorded CC&Rs or homeowners' association documents and plat maps.

A title search (or **"chain of title"** history) will be reviewed and closely analyzed in order to better learn about who really currently owns the property, which valid debts or liens are placed against the property, and other conditions of title such as accurate addresses, zoning types, and whether the neighbor's fence was wrongly placed on the subject property (a type of encroachment). The title company will probably send out the principals and agents copies of a preliminary title report in the early stages of the transaction before later sending out a final title commitment for the property which defines and describes all of the defects being insured and protected against by the title policy. A property with unmarketable title due to a murky "chain of title" history may not be able to be sold by a seller to any qualified buyer unless the title defects are cleared up.

Some title companies (especially in Northern California) will handle the property closings just like an independent escrow company. They will follow the same steps outlined above for most escrow companies which includes the collection and disbursement of all funds and the transfer of the title to the property once the deal funds, records, and closes escrow.

Unlike a homeowner's insurance policy that is paid monthly or a few times per year, the premium cost for a title policy at the time of closing is a one-time fee that is paid at closing. A homeowner's insurance policy is requested by property owners as a way to obtain coverage against future

losses related to fire, lightning, severe wind, or other types of extreme weather events, theft, and personal injuries that might occur on the property.

As required under California law, each title insurance company, underwritten title company (agent or parent company of multiple companies), and the owned or controlled escrow company must file its own schedule of rates, forms, and potential new rate modifications with the Insurance Commissioner.

The posting of title insurance companies' rates and fees allows consumers to shop and compare title fees before making their selection. It will be the person who ends up paying for the title costs who ultimately decides which title insurance company they want for the transaction.

Some title insurance companies will offer discounted rates below their normal quoted prices for these types of situations:

- A subdivision bulk rate for home builders or buyers;
- A "short-term rate" for a property that was insured before or sold within the past five years;
- A concurrent discount rate if the title company is providing more than one type of policy (owner's and extended or lender's title);
- A discount for some first-time homebuyers; and
- Refinancing discounts for previous customers.

Types of Title Policies

The two main types of title insurance coverage policies in California are: (1) a standard coverage policy and (2) an extended coverage policy.

Standard coverage policy: A standard coverage policy is the more popular type of title insurance coverage option partly because it is the one that is more affordable . With less coverage protection, the owner and

lender may have more risks, however. A standard policy covers or protects against physical defects and public-record issues.

Most standard coverage policies will insure against such public-record issues as tax liens, judgments, and mechanic's liens from past contractors. It will also insure against certain off-record risks such as fraud in the chain of title (e.g., a forged grant deed transfer from 10 years back), defective recordings due to the wrong street address or lot, block, or tract number, and the incompetency of parties involved in current or past transactions (e.g., their age and mental health status at the time of the signing of the grant deed).

Extended coverage policy: An extended or lender's coverage policy includes all of the same coverage benefits found with standard coverage policies, plus additional protection for things like off-record risks that are more challenging to find or uncover. Sometimes, the title insurance company will send out an employee to physically inspect the property for hidden defects or ask neighbors about any potential easement or encroachment risks for the subject property that are not part of the public record. Other types of off-record risks that may be insured against are unrecorded mechanic's liens, land contracts, and lease agreements.

Some lenders might require the borrower to pay extra money for the extended coverage policies for properties that are more expensive or considered risky for the lender.

The following is an example of how a lender's title insurance policy might apply to a property:

Example: A purchase money lender provides a requested loan to the borrower/buyer in the amount of \$825,000 as a first mortgage lien after the lender reviews the title policy which shows no liens of record at the time of sale against either the seller or the property itself. After the buyer comes in with an additional \$250,000 cash to close, the seller walks away with \$1,075,000 in sale proceeds (less several thousand in closing costs

and \$60,000 paid out to the buyer and listing agents). The buyer, the agents, and especially the seller are all quite pleased.

Shortly thereafter, an undiscovered income tax lien from the IRS (Internal Revenue Service) in the amount of \$614,578 is found against the property that did not appear the previous time that the title company completed its title search or chain of title search. Since the IRS has a lien in first position with rights greater than the new mortgage, the lender's jumbo mortgage loan is now in second position.

Should the IRS later foreclose on its \$614,578 tax lien that grows and compounds in size on a daily basis, the lender's \$825,000 loan would be wiped out at the final foreclosure auction sale if there were no buyers for the property or if the winning bid was not high enough to pay off the lender's full loan amount (i.e., the winning bid amount would need to be higher than the \$614,578 IRS tax lien + the \$825,000 mortgage + foreclosure fees, trustee fees, late fees, and interest). It is highly unlikely that a sophisticated third-party investor at a foreclosure auction would pay over \$1.5 million dollars for a property that is worth closer to \$1,075,000.

Any foreclosure actions taken by the IRS would wipe out the buyer's \$250,000 cash investment that was applied towards the down payment. It would also probably wipe out the lender's \$825,000 loan. That would leave them both with significant financial losses. In some tax lien cases, the person who has the lien filed against him or her is not aware of it because he or she may have moved several times, had not forwarded the mail, and never saw a certified copy of the tax lien. If this was the case in the example, the seller had not committed any fraud at the time of sale because he was not aware of the lien filed against his property.

It will be up to the title insurance company to cover the financial losses for the lender even if it means having the title company issue a check for close to \$825,000. If so, the thousand or few thousand dollars paid the one time by the buyer, seller, or some combination of both for the title

premium at closing will have proven to be an exceptional investment, especially for the lender who had not paid any of the title insurance fees.

The Real Estate Settlement Procedures Act (RESPA), a legislative act passed by Congress in 1974 and codified as Title 12, Chapter 27 of the United States Code, 12 U.S.C. §§ 2601 - 2617, has some main objectives that were enacted with the intent to protect homeowners from being unfairly taken advantage of in the home purchase process. The passage of RESPA led to the creation of better financial disclosure forms and price comparison sheets that consumers could review while shopping for the best service options at the lowest prices.

RESPA made it unlawful for title insurance agents, escrow personnel, and other business professionals to offer any kickbacks or referral fees to real estate agents who had first recommended that the client work with that one specific title or escrow company. RESPA, and other future disclosure forms like TRID, were created to make the customer as fully informed as possible by requiring that title, escrow, and lending companies notify their clients of the actual fees that they are about to be charged within just a matter of a few days at the start of the transaction. A more informed consumer should not be as easily taken advantage of by unscrupulous principals, agents, escrow agents, or title officers thanks to RESPA.

Taxation

Some buyers may bring in large amounts of cash to close their purchase deal at an escrow company. In situations where the amount of cash exceeds \$10,000, it must be reported by the escrow company using IRS Form 8300 (subject to change). The gross proceeds to the seller are reported on IRS Form 1099S. Often, a person must send in a 1099 tax form after paying the same party more than \$600 in income within the same calendar year, especially real estate commission income.

A closing agent must include the seller's name, social security number, and the gross proceeds from the home sale on the **IRS Form 1099-S**. The gross proceeds figure on the 1099 form is generally the same as the sales price. The escrow officer may not charge the seller an extra escrow fee for completing this IRS form.

An exemption to this rule for reporting requirements to the IRS is for the sale of an owner-occupied primary residence that meets the latest tax code guidelines for length of time (typically more than two years), profit earned, and the seller's relationship status as a single or married person. The first \$500,000 from a home sale is tax-free for married couples and \$250,000 is exempt from taxation for an individual. Taxes will be owed for profit above those amounts. Under the eyes of tax agencies, a person's **primary residence** is defined as the place where a person lives for most of the year.



Foreign Investors: The **Foreign Investment in Real Property Tax Act (FIRPTA)** was implemented in 1980 to prevent foreign investors from evading tax liability in the United States. California has a very large share of foreign investors who purchase residential and commercial properties. Should the seller be determined to be a foreign resident, the buyer must withhold 15% of the amount realized from the sale of the property and forward that amount to the IRS. The 15% funds must be sent to the IRS within 20 days after the closing date. It is usually the closing or escrow agent who sends in the sales proceeds to the seller on behalf of the buyer.

For example: The seller will net \$1,000,000 in profit from the sale of a 10-unit apartment building. The buyer (not the seller) will then set aside 15% of the \$1 million dollars (or \$100,000) before later sending it to the IRS in accordance with the FIRPTA requirements.

California Withholding Law: In some transactions with foreign or American sellers, the escrow officer might be required to set aside an additional 3.33% of the sales price from the seller as a type of prepayment of any state income tax that is due on the gain. If so, the closing agent will send the funds directly to the Franchise Tax Board.

Chapter Eleven Summary

- Most escrow transactions are closed with either an independent escrow company as is more common in Southern California, or with the assistance of an escrow company owned by a title insurance company as is more common in Northern California.
- There is one main **escrow officer** or **escrow agent** (also referred to as the **closing agent**) assigned to each transaction. The escrow agent owes a fiduciary duty to both the buyer and seller just like a dual agent in real estate.

- All independent escrow companies must be established as **corporations** in the state of California.
- The **California Department of Business Oversight (DBO)** agency is the primary governing agency in charge of escrow companies. The Division of Corporations, a subagency under the DBO, handles most of the oversight and regulations of escrows under the DBO's supervision.
- Buyers and sellers each have their own sides of a **closing statement** or **net sheet** that is like a financial ledger or accounting spreadsheet. Escrow agents will present these closing statements to each party to the transaction with a list of credits and debits for each side.
- **Title insurance** protects against potential “clouds on title” (or defects) that can adversely impact the clear ownership of property. It is the title insurance that determines if a property has valid or “marketable” title.
- A title insurance policy can protect owners from risks associated with items on public record and certain off-record risks such as unrecorded liens or leasehold interests. The title company completes a “**chain of title**” search examining all past owners and lenders of record for the subject property.
- A **standard coverage policy** offers protection against more items that can be found on public record (most affordable title policy option). An **extended coverage policy** (also called a “lender's coverage policy”) provides the same standard coverage policy benefits plus additional off-record risk protections.
- The passage of **RESPA (Real Estate Settlement Procedures Act)** lead to the creation of better financial disclosure forms and price comparison sheets that consumers could review while shopping for

the best rates. It also prohibits “kickbacks” (or paid referral fees) for business professionals who suggest their clients use the services of a certain escrow, title, or lending company.

- **Capital gains taxes:** An unmarried property owner who sells his residence may collect up to \$250,000 tax-free (\$500,000 for a married couple) if the seller has lived in the residence for at least two years.

Chapter Eleven Quiz

1. When dealing with principals and brokers, an escrow company acts like a _____.
 - A. Trustor
 - B. Vendee
 - C. Beneficiary
 - D. Fiduciary
2. The main governing California agency in charge of independent escrow companies is the _____.
 - A. Department of Corporations
 - B. California Department of Business Oversight
 - C. Bureau of Real Estate
 - D. Department of Finance
3. All independent escrow companies in California must be established as _____.
 - A. LLCs
 - B. Sole proprietorship
 - C. Corporations
 - D. Partnerships

4. An escrow officer will send a demand for payoff to the _____.
A. Borrower
B. Seller
C. Seller's mortgage lender(s)
D. Broker
5. What will be the buyer's biggest expense listed on their side of the net sheet?
A. Earnest money deposit
B. New loan
C. Purchase price
D. All closing costs combined
6. Which closing costs will *not* be prorated by an escrow agent?
A. Property taxes
B. Mortgage interest
C. Homeowner's insurance
D. Escrow fee
7. Which is the most likely to be a recurring closing cost?
A. Property taxes
B. Title fees
C. Repair fees
D. Escrow fees
8. The Documentary Transfer Tax is assessed at a rate of _____.
A. 1% of sales price
B. \$0.55 of every \$500 of the sales price
C. \$1.10 of every \$1,000 of the sales price
D. Both B and C

9. Any changes made *after* the escrow has been opened are considered _____.
A. Modifications
B. Amendments
C. Rescissions
D. Novations
10. What is another name for a “cloud on title”?
A. Chain of title
B. Defects
C. Beneficial interests
D. Equitable interests
11. The extended coverage policy that is offered by title insurance companies includes _____.
A. Mortgage insurance guarantees
B. Standard coverage policy benefits
C. Certain off-record risks
D. Both B and C
12. Which tax form does an escrow company send out in January regarding commission fees paid out to a real estate agent?
A. W-2
B. 1099-S
C. 1091
D. W-9

Answer Key:

1. D	6. D	11. D
2. B	7. A	12. B
3. C	8. D	
4. C	9. B	
5. C	10. B	

CHAPTER 12

LEASING AND PROPERTY MANAGEMENT

Overview

In some regions of California, there are more tenants than owner-occupants in residential zoned properties. After millions of properties were foreclosed on in the state in the years following 2007 and the terrible credit crisis, many homeowners switched from owning to renting property. Many real estate agents make a full-time career of working on the residential and commercial leasing side of the business that can also provide them with consistently good income. This chapter will cover the most prevalent types of lease contracts and provisions used today, the expected roles of licensed property managers, how tenants and owners will handle the assignment of leases, and the early termination and eviction of occupants.

Increasing Rents and Property Prices

California is home to some of the most expensive real estate in the world. In some of the more prestigious coastal and crowded metropolitan regions like Los Angeles and San Francisco, it is not uncommon for tenants to pay upwards of \$10 per square foot to lease an apartment unit. A 300-square-foot micro-apartment might rent today for \$3,000 per month. While the cost per square foot increases, the size of the leased space seems to decrease!

People who live and work near these coastal or downtown metropolitan areas may have just a few housing options. These options might include paying \$2,500 or \$3,000 per month to rent a small unit, buying a home

priced over \$500,000 in many areas, or sharing housing space with other working-aged adults by renting rooms or even sharing rooms with friends or family.

Across the state, rent prices have outpaced income. As a result, fewer working-aged adults are able to afford living alone. Some single-family homes these days may have several adults sharing the property and splitting the rent. This is especially true in the more expensive areas of California like San Francisco and Los Angeles.



Let's take a look below at some of the latest leasing trends across the nation and our state:

- Almost 45% of adults live with either one or more roommates or a parent. This figure is about double the percentage it was in 2000.
- Three of the regions in the nation with the highest share of adults living with a parent or roommate are found in Los Angeles, Riverside, and Miami.
- Nationally, on average, a person will spend about 30% of their monthly income on rent. In Los Angeles and San Francisco, however, a tenant has typically spent about 50% of their income on rent in recent years.

The more expensive the housing region, the greater the odds of tenants living together. In San Francisco, the most expensive area in the nation to rent, tenants spend about 50% of their income on rent every month. Interestingly, Los Angeles was rated the third most expensive rental market in the nation according to *Zillow* in 2017. But by early 2020, with median rents reported at \$2,375 per month for a one-bedroom apartment, it has “fallen” to the sixth highest rental area in the country. (Note that rents have come down a bit nationwide and particularly in California since the pandemic began, so the statistics for 2020 may be a bit skewed until the economy has bounced back.)

An estimated 45% of adults living in the more “affordable” inland city of Riverside, California live in doubled up or shared housing situations. Historically, Riverside was one of the more affordable places to live in the state as compared with the pricier coastal regions in the adjacent counties of San Diego and Orange. After years of the coastal areas’ rapidly increasing living expenses, more state residents moved inland to areas like Riverside County and decided to commute to work one-to-three hours round trip each day.

Zillow reports that some other metropolitan regions in the western states with a high percentage of adults living together with roommates are as follows:

- Seattle - 28.3%
- Portland - 28.5%
- Phoenix - 32.2%
- Denver - 27.1%
- Sacramento - 33.1%

The most-recent statistics from *ipropertymanagement.com* show that more Americans are renting today than at any other time in recent history. Households with renters make up about 36% of all households nationally. The home ownership rate remains high at about 64%. An estimated 79% of tenants who moved in the last year said that their rent had increased before they moved. And approximately 57% of tenants who were polled said that their latest rent increase was the main reason they moved.

An estimated 25% of renters had to move to an area far away from their desired region to find property that was more affordable. About 37% of tenants surveyed who had not moved in the previous year said that they cannot afford to move elsewhere. Almost half (48%) of respondents who make less than \$25,000 per year said that they cannot afford to move. According to 2020 U.S. Census Bureau data, nationally, the median annual income per person is 34,103.

Opportunities for Agents

The fact that rents and home prices reached near record high levels in recent years is still a serious problem for many state residents today. Even with rent prices down a bit due to the pandemic, they remain higher than many people can afford. However, this can also be a new opportunity for real estate agents who are seeking tenants and new home buyer prospects to work with. The frustration level for so many tenants is

probably at record highs because such a large percentage of their gross monthly income is still going towards rent. After factoring in taxes, inflation, groceries, and utilities bills, many people have literally not a single penny left at the end of each month.

Real estate agents might consider attending monthly gatherings at some of the larger apartment complexes as a way to meet and educate prospective customers about how they can qualify for FHA loans for brand new homes in the same region, county, or within a 30-mile driving radius. A savvy and creative real estate agent can put together four-color postcards that compare the apartment building's median rent prices being paid each month with a proposed new FHA mortgage with just 3.5% down.

A sample comparison between current rents for apartment units and a new FHA loan (4% fixed rate, amortized over 30 years) for a new 2,000 square home with a large backyard, 3 bedrooms, and 2 baths may be as follows:

<u>Rent</u>		<u>New Mortgage</u>
\$2,750 per month	vs.	\$2,000 per month*
775 square feet		2,000 square feet
1 bedroom, 1 bath		3 bedroom, 2 bath

* Principal, interest, property taxes, homeowners insurance, and mortgage insurance premium payments

Many tenants do not understand how the mortgage qualification process really works, especially if they have never purchased a home before. First off, most tenants do not think that they have sufficient levels of income and assets to qualify to purchase a home. They may believe that a 20% down payment is required. With home prices in some areas averaging over \$500,000, a 20% down payment would be \$100,000 or more. Since few young people today have over \$10,000 in liquid savings, the tenant

may think that buying a home is not an option for them.

In the history of real estate in California, it is unprecedented for median rent prices to be higher than median mortgage payments. Yet this has been happening across the state. Surprisingly, new affordably-priced homes and apartments are not being built at a pace to keep up with the demand.

Agents can help teach tenants, family, and friends about how a new FHA mortgage loan that offers mortgage interest and property tax deduction benefits for owners (unlike rental payments that offer minimal tax benefits and absolutely no wealth creation for anyone besides the landlord). With some of the more creative types of FHA financing, a new buyer can have most of their down payment and closing costs gifted by family members and credited by the sellers or builders. With these types of deals, the buyer might have to spend only \$1,000 or \$2,000 to close escrow.

For other real estate agents interested in working more as a full-time leasing professional or onsite property manager, the income paid today may be the highest it has ever been in the leasing profession if the leasing managers are paid a portion or all of their income as a commission that is based on a percentage of the lease payments. In apartment buildings with 100 units to manage with an average rent close to \$2,500 per month, the onsite manager may be collecting \$250,000 per month in rent. Some property owners may pay their onsite leasing professionals a fixed monthly salary plus a small percentage of the monthly rents collected. A 1% commission bonus on \$250,000 per month is \$2,500 per month; 2% would be \$5,000 per month.

On the commercial real estate side of the business, some of the most successful and wealthiest real estate agents spend the bulk of their time working with large businesses that seek prime office or retail shopping space. The commission paid for leasing deals for 100,000 square feet of commercial space, when signed for long periods of time of over five or ten

years, can generate \$100,000 to \$500,000 or more in commissions for real estate agents. Each time their business tenant decides to move up to even larger office space, the commercial leasing agent will probably have the opportunity to assist them for many years or decades.



Investment benefits

Real estate investors who acquire rental properties are focused primarily on generating some type of consistent cash-on-cash return for many years. Rental properties can provide property owners with three main categories of investment returns:

- Appreciation
- Leverage
- Cash Flow

Appreciation and Amortization: The increase in property value over a short or long period of time. Historically, home prices in California and across the nation have appreciated in value at an annual pace that is at least as high as the stated annual inflation rates in recent years. Thus, real estate is considered to be one of the best hedges against inflation (a hidden form of taxation and a destroyer of the dollar's purchasing power).

Some properties in California have compounded in value at a much faster pace by doubling in price every seven to ten years. For some fortunate property owners who owned their properties longer than their 30-year mortgage, the property value increased by several hundred thousands of dollars or a few million for some coastal properties. In addition, the mortgage debt is fully amortized and paid off. At this point, the property owner has a property with no mortgage debt and a tenant willing to pay rents higher than many people's mortgage payments.

Time + Appreciation + Debt Amortization = Solid Equity & Net Worth

Leverage: Using other financial institution's funds to acquire assets that generate consistent monthly income and an increase in overall value over the years is one of the main benefits of leverage. Some property owners

may buy a home to live in full-time as their primary residence with anywhere between 0% and 5% (VA or FHA loans), live in the property for several years, move elsewhere, and then rent the property to a new tenant. If the owner locked into a relatively low mortgage rate for 30 years, then the tenant's monthly rent payment may be much higher than the owner's monthly mortgage payment.

Cash flow: Cash flow is the difference between income from the property and the expenses associated with it. The expenses may include operating costs (e.g., management fees, advertising, maintenance, etc.), mortgage payments, insurance payments, and property taxes.

Leasehold Interests

Tenants hold interests (leasehold) in properties that they lease just like owners hold interests (equitable) in the same properties. A licensed property manager who assists with the leasing of a property should understand what sort of legal rights the tenant has once they agree to occupy the premises. The **lessor** in the lease contract is the owner or landlord, the **lessee** is the tenant or renter, and the licensed property manager is the **agent** who makes sure that both the tenant and the landlord's interests and needs are met, per the terms of the signed lease agreement.

The four most common types of leasehold interests in properties are as follows:

- 1) **Estate for years:** This description can be quite confusing and misleading to tenants and landlords. It is a type of lease agreement that has a specific beginning date and ending date that may be much shorter than one full year (e.g., January 1, 2018 - October 31, 2018) or longer (e.g., January 1, 2020 to December 31, 2021). No notice to vacate is required by either side because the ending date has already been firmly established at the start of the signed lease agreement. The rights and

obligations of both parties are spelled out in the lease. The only way to terminate the lease agreement early is if both parties mutually agree to it.

2) **Estate from period to period:** This is a lease agreement that continues for periods of time (also referred to as a **periodic tenancy**) such as month-to-month or year-to-year. The most common type of periodic tenancy is the month-to-month tenancy agreement often seen in larger apartment complexes.

The landlord and tenant, directly with one another or through a designated leasing or licensed agent, will agree upfront to certain rights and obligations that they must both adhere to during the defined time periods. However, there is no definitive ending date built into the agreement. To end the lease agreement, the landlord or tenant must give the other party sufficient notice that they intend to vacate or change the terms of the agreement by increasing the rents. Otherwise, the lease will continue as is with the same rights and obligations of all parties that was set out in the original lease.

3) **Estate at sufferance:** This type of lease agreement situation exists when a tenant continues to live in a rented property well after the signed lease term has expired. The landlord has not demanded that the tenant vacate the property or terminate the lease and continues to willingly accept the same monthly rent check from the tenant. The tenant must agree to follow the terms and conditions outlined in the original lease agreement and make the same rental payments on time to keep the tenancy at sufferance situation in place. Should the tenant stop paying the rent on time or if the landlord wants a much higher rental payment, then the lease termination and eviction process may follow.

4) **Estate at will:** An estate at will is a type of tenancy agreement where a tenant occupies a property with the consent of the owner (also known as a **tenancy at will**), but there is no formal agreement in place that specifies a definite rental period or a regular and consistent payment of rent. The lease agreement can be terminated by either party at any time

and can exist without a formal signed contract in hand and with or without an exchange of payments. For tenants and landlords seeking more flexibility with the option to change rents or locations more frequently in a much shorter time period, the tenancy at will agreement might be their first choice.

Which leasehold interest has a definite starting and ending date for less than a year?

Lease Types

Lease Applications and Contracts

California is home to almost 40 million residents. Many of the state's residents were born in other nations and still speak their native language more than they speak English. When negotiating with tenants who speak multiple languages, the agent and landlord should present copies of lease contracts in both the tenant's native language (Spanish, Vietnamese, Chinese, etc.) *and* in English.



A lease contract can be drafted with just a few paragraphs or over several pages, depending upon the instructions given by the landlord. Most residential and commercial property leases should include at least the following sections in the contract:

Party names: All lease agreements should include the names of all tenants over the age of 18 who intend to occupy the property. If the main tenant is under the age of 18, his or her parent will likely have to be a cosigner and approve the lease contract in most cases. In situations where there is more than one applicant, each party who signs the lease (whether a tenant or a cosigner) should include the words “jointly and severally” so that each party fully understands that they share equal financial liability should one or more of the other tenants later default on the lease agreement and get evicted. The financial liability holds, regardless of whether the tenant or cosigner lives in the property or not.

Property address: The street address, unit number (if applicable), and legal description should be noted in the lease agreement.

Property description: For properties in high-rise buildings or that share common areas, the landlord should include details about designated parking spaces and the available amenities in the complex, such as any shared pools, clubhouses, or gyms. The landlord might note that the tenant is able to possess and occupy the airspace between his walls as well as some of the common area space during specific time ranges.

Dates: The dates that are selected in a leasing contract will also help define the type of initial leasehold interest that the landlord is assigning to the tenant at the start of the lease agreement. For any lease agreement with a definite start and end date, it will be considered an estate for years contract. Other contracts that are structured as month-to-month agreements with a specific start date and a time-period designation is a periodic tenancy agreement. Again, most lease agreements for larger apartment buildings are structured as some kind of periodic tenancy agreement.

Rent amount: The rent amount should be clearly listed in the contract so that there are no misunderstandings between landlord and tenant at a later date. The contract should clarify for how long this rental payment will last before the landlord has the legal right to increase the rent with sufficient notice provided to the tenant. Some residential and commercial lease agreements have inflation clauses built into their agreement which allow the landlord to automatically increase the rents by 3% or more each year for lease agreements that last for several years or more. The due date for each monthly rent payment should be confirmed as well as when the rent is considered late.

Late Fees: The contract should detail how much the late fees are should the tenant pay the landlord one day past the monthly due date. For example, some landlords will say that rents are always due on the first of the month with a grace period that may last another three or four days until the fourth or fifth of the month (holidays excluded). The landlord should let the tenant know in the written contract the exact day of the month when the tenant will be required to pay a late fee over and above the monthly payment amount. Some late fees may be equal to 3% or 5% of the monthly rent payment amount.

Cleaning and security deposits: These deposits are typically requested from landlords as a form of extra financial security in the event that the tenant damages the premises. It is similar to a type of insurance for the landlord as they offer some layers of protection against such things as ruined carpets, broken appliances, holes in the walls, or even just filth.

Per California law, the amount of a security deposit that may be collected from a tenant is limited to an amount equal to two months' rent for unfurnished residential units or properties, and up to three months' rent for furnished properties. For an unfurnished apartment unit that is priced at \$1,000 per month for a one-bedroom unit, for example, the landlord has the legal right to ask for \$3,000 upfront (\$1,000 for the first month's rent and \$2,000 for the combined security/cleaning deposit). The landlord is restricted from attempting to collect any additional fees for

deposits that exceed the combined two months' worth of rent or listing the "cleaning deposits" as non-refundable deposits.

Inspection: There should be a section in the contract which states how a landlord, or his or her designated licensed agent, will inspect the property with the tenant both at the start and end of the lease term. Shortly after the tenant vacates the property, the inspector will make a record of any interior damage that will be deducted from the tenant's security deposit. It would be beneficial to agents, landlords, and tenants if the space is filmed before the tenant moves in and immediately afterwards to compare the conditions of the property.

Pets: Some landlords will not allow any pets whatsoever. For those landlords who do allow dogs, cats, or other pets, they may request a larger security deposit. The lease agreement may also include references to noise problems associated with barking dogs and what sort of remedy the landlord has to deal with this issue, such as the legal eviction of the tenant. Pets can potentially cause a lot of damage to floors and drapes, so this clause should be clearly identified and explained when working with tenants who have pets.

Right of entry: Many lease agreements will include a clause that allows the landlord a right of entry back into the unit even when leased to tenants. The landlord must usually give the tenant more than 24 hours' notice before inspecting the property for things like reported damages. For potential emergency situations, such as a gas leak that might require immediate action, no 24-hour notification is necessary.

Exculpatory clause: This is a type of "hold harmless" clause that most landlords want included in their lease agreement. The tenant agrees to relieve the landlord of any potential financial or legal liability for matters such as injuries on the property, like someone "tripping and falling" or sustaining a personal injury after incorrectly using a microwave or other appliance. Even though many residential lease agreements contain this "hold harmless" clause, they may not be valid or enforceable in court

should someone file a civil complaint for damages and the landlord is found to have been negligent.

What a Tenant May Expect from the Landlord

There is an **implied warranty of habitability** in most types of residential lease agreements. The legal definition is that all residential premises are fit and habitable at the start of the lease agreement and throughout the duration of the lease term.

The landlord is expected to maintain his property in a state or condition that is truly livable for the tenant who continues to pay the rent on time. Some of the most important amenities in a property that must remain in decent working condition include:

- Heating and air conditioning
- Lights and electrical
- Plumbing -- sinks, showers and toilets in working condition
- No leaky roofs or flooded basements
- No holes in the floors or walls
- Properties that are free from pests like termites
- Fully functional locks and security systems (if applicable)

Should the landlord refuse to make any significant repairs to his property that makes it unlivable while still collecting the monthly rents, the landlord could be liable for actual damages sustained by the tenant and potential special damages that might range from a low of \$100 to more than \$5,000. The same tenant could make a claim that the landlord is breaching the **implied warranty of habitability** as a way to prevent eviction actions filed by the landlord.

If the landlord does not make corrections or repairs within a reasonable amount of time after being requested by the tenant, the tenant's options may include:

1) asking a small claims court, mediator, or arbitrator to resolve the dispute. In California, the maximum amount of money that a person can seek against another person is up to \$10,000 in small claims court. Should the damages exceed \$10,000, the claimant or plaintiff would look to a local superior court that has unlimited damage potential.

2) breaking the lease and moving out of the property without being legally liable for unpaid rents or early lease termination.

3) calling a professional handyman to make the repairs, paying the repairman directly, and deducting the cost of repairs from the next rent payment.

4) not making repairs himself and not hiring a handyman to make repairs, but paying a reduced amount of rent to the landlord because the unit is not habitable. For options like this one and number three above, the tenant should keep detailed records of conversations with the landlord or leasing agent as well as financial records of any costs incurred for attempting to take care of the repairs alone. Detailed receipts of any repairs performed should be carefully maintained.

It is also a good idea to take photographs or video of any issues that are making the unit uninhabitable and keep them with other detailed records of conversations and receipts.

Tenants' Responsibilities

The tenant's main responsibility in a lease contract is to pay the monthly rent on time. Beyond that number one requirement, the tenant must not make too much noise or damage the property intentionally. Other tenant responsibilities, according to the California Civil Code, are that the tenant must:

- Use the property for lawful purposes.
- Keep the space clean and sanitary.
- Follow the rules and regulations.
- Don't bother the neighboring tenants.
- Dispose of garbage and other waste properly.
- Give a 30-day notice to the landlord when vacating (periodic tenancy).
- Return any keys to the unit and mailbox when vacating.
- Leave the unit in the same condition as when the tenant first moved in.

Assigning or Terminating a Lease

Some lease agreements will allow the tenant to assign their leasehold interests in the property to another qualified credit applicant before the lease term expires. With an **assignment**, the tenant transfers 100% of their rights and interests in the property to a new third party.

The original tenant is the **assignor** while the new tenant (third party) is the **assignee**. The new tenant/assignee will then pay the monthly rent directly to the landlord. The assignee (new tenant) now has the primary responsibility and financial liability for the monthly rent and remaining term of the lease agreement. However, the assignor (the original tenant) has secondary liability behind the assignee. Should the assignor later default and still owe the landlord \$2,000 and skip town, the assignor (original tenant) shall be required to pay the landlord the full \$2,000.

The **sublease** of a property only transfers a portion of the original tenant's leasehold interests to another party before the expiration of the existing lease term. The **lessor** is the landlord, the **lessee** is the original tenant, and the **sublessee** is the new tenant who took over the leasehold interests from the lessee.

The sublessee will pay the monthly rental payment directly to the lessee

(original tenant). The lessee, in turn, will then either forward the same check or his own new check to the lessor (landlord). The lessee acts somewhat like a middleman between the landlord and sublessee. Because the lessee is “sandwiched” between two parties, it may be said that the lessee is holding a *sandwich lease*.

Lease Termination

A lease that does not have a specific end date already built into the original lease term may be terminated early by one or both parties under the following circumstances:

- The tenant may end the tenancy due to the landlord’s failure to make the requested repairs within a timely period.
- The tenant may vacate if she or he was the victim of domestic violence on the premises.
- The landlord may evict the tenant if the tenant has too many occupants.
- The landlord may evict the tenant if the tenant damages the property, intentionally or unintentionally, through reckless actions.
- If either side breaches or violates a condition included in the lease, the lease may be terminated by either the landlord or the tenant.
- If the tenant vacates a property in disrepair while claiming a violation of the implied warranty of habitability, the original lease term may be terminated by the tenant.

- If the tenant uses the property for illegal reasons such as selling or making drugs on the premises, the lease may be terminated by the landlord.

Protecting Tenants When Property Goes into Foreclosure



Between 2006 and 2010, there were millions of foreclosure filings in the state of California alone. Prior to 2009, a foreclosure action that was completed by a lender would wipe out or terminate any existing leases on the subject property. Back then, the lender could foreclose on the home and legally evict the tenant shortly thereafter after providing sufficient notice about the ownership change. This was very unfair to tenants who had lived there for many years and never missed one rent payment.

The year 2009 was an especially challenging year for foreclosures statewide and nationwide as the foreclosure numbers reached levels never

seen before. The combination of adjustable rate mortgages rising to levels that were twice as high as the original payments a few years prior, the disappearance of equity line programs as a first or second lien, and the disappearance of so many “EZ Doc” (“stated income” and/or “stated asset”) programs only worsened the default rates because property owners had lost most of their options to refinance or pull cash out to continue making payments.

The downward foreclosure spiral only worsened after property values fell 10%, 20%, and more in certain regions over the period of a year or two. With properties going “underwater” (where the mortgage debt exceeds the current property value), many properties were not appraising high enough to qualify for new loans or quick home sales to new buyers. Some communities had more foreclosure actions surrounding their homes than actual home sales between motivated buyers and sellers. These discounted foreclosure actions became the latest sales comparables for homeowners, unfortunately, causing property values to plummet.

The federal government finally had to step in and provide more foreclosure and tenant relief options for people who were getting evicted from homes in record numbers. Many people should be aware of the foreclosure assistance programs that would delay foreclosure actions for upwards of several months or years for property owners. And not many people are aware of tenant-relief laws that were enacted to better protect the rights of tenants who were being evicted through no fault of their own after their landlord was foreclosed upon by his or her lender.

The **Protecting Tenants at Foreclosure Act (Tenants Protection Act)** was passed via the Dodd-Frank Wall Street Reform and Consumer Protection Act. It was enacted by way of the Office of the Comptroller of the Currency (OCC). The act was part of the **Helping Families Save Their Homes Act of 2009**.

One of the main purposes of this act was to protect bona fide tenants living in properties (with federally related mortgage loans secured by

residential properties) that were in foreclosure. The owner of the property who had the title transferred either back to the foreclosing bank or to a new third-party investor was required to allow the tenant to remain in the rented home under the same lease conditions and terms as he or she had agreed to under the original lease. Since most residential loans nationwide are considered “federally related loans” (e.g., FHA, VA, USDA), then this tenant protection act helped the majority of tenants living in properties with a defaulted mortgage from being evicted prior to the end of their lease term.

Two main exceptions or explanations for this tenant protection rule after foreclosure are:

- The tenant is entitled to 90 days’ notice to vacate when they hold a month-to-month lease tenancy in hand that has no definite termination date.
- If the buyer at a foreclosure auction intends to occupy the property as his primary home, the lease may be terminated with 90 days’ notice.

It is illegal to evict a tenant for reasons related to their ethnicity, nation of origin, gender, or other protected class reasons that are covered under state and federal Fair Housing laws.

Evictions and Unlawful Detainer

A landlord, or his appointed leasing or licensed agent, may bring an unlawful detainer and eviction action against a tenant for the nonpayment of rent or the continued willful violation of provisions or conditions set out in the lease agreement. The landlord will probably issue a 30-day or 60-day written notice to pay or vacate, depending upon how late the tenant is with his rent payments. Should the tenant not pay

the back rent and late fee penalties, the following steps may be taken by the landlord:

- 1) The landlord serves the tenant with a **three-day notice to pay or quit**. The word “quit” means to “voluntarily vacate” the premises without being legally locked out by a sheriff or some other court officer.
- 2) If the tenant does not pay their back rent, then the landlord will file an **unlawful detainer** in court. This legal action is a special court proceeding that is used to evict someone from the place where they live or work. This action can be brought against someone who refuses to leave the premises after their lease term is up, the lease is canceled, or the landlord is still owed back rent and late fees.
- 3) If the court agrees with the landlord and awards him or her a judgment, the landlord will ask for a **writ of possession** to grant the landlord the legal right to take back his or her property, and possess and occupy it again or lease it to someone else. With the writ of possession, the landlord is asking the court for the right to authorize the sheriff to remove the tenant from the property.
- 4) The local sheriff’s office will send out one of its employees to personally tell the tenant to leave. Should the tenant not vacate the premises on his or her own, the sheriff has the legal right to physically remove the tenant from the premises.

The landlord cannot physically or emotionally threaten or intimidate the tenant to vacate the property. The landlord cannot harass the tenant by way of asking neighboring tenants to turn the stereo speakers up loud or attempt to embarrass or humiliate the tenant for missed payments. If the landlord does threaten or harass the tenant, the landlord may be subject to thousands of dollars of damages. The landlord’s agent who wrongfully assists the landlord with unfairly trying to evict the tenant could face a significant fine and/or lawsuit, and possible restrictions on or revocation

of his or her real estate license. As such, it is much safer and wiser for both landlords and agents to let court-appointed officials handle the evictions.

Property Types

Most types of property can be leased with or without a building on it. Some farmers may lease raw land to grow their crops. The most popular types of properties that are leased and managed by licensed real estate agents include:

- 1) Residential properties
- 2) Retail centers
- 3) Office buildings
- 4) Industrial properties

Residential properties: The residential properties may range from a single-family home, condominium, townhouse, or co-op unit to a 500-unit multifamily apartment building. What these properties all have in common is that the individual living space is usually within one unit. A duplex, triplex, and fourplex property will each have two, three, and four individual units, respectively, that are typically leased out separately to different tenants.

Apartment buildings are the likeliest to have onsite property managers or leasing agents. Some part-time real estate licensees will be offered a free unit to live in on site in exchange for assisting with some minimal property management services. Other licensees might be offered a free place to live, a salary, a bonus payment for high occupancy percentage rates, and a percentage of the collected rents if they work full-time for the property owner.

Both the agent and the landlord must follow the latest landlord-tenant

laws. Most lease terms for larger apartment complexes are for fairly short periods of time such as a six-month or one-year term. Or, they are offered on a month-to-month term with no end date listed in the original lease contract. As a result, these apartment buildings will probably have a relatively high turnover rate. The onsite property manager may spend a great deal of time each week handling calls from new credit applicants or placing ads trying to find new qualified tenants to occupy the recently vacated space.

Retail centers: A retail center may consist of just five or six small stores located in a neighborhood strip mall. Or, it can be a much larger retail shopping center with over a hundred tenants occupying the space. Lease payments are based upon square footage and location. Most tenants will sign relatively long-term lease agreements because the landlord may add thousands or hundreds of thousands of dollars in new **tenant improvements** (restaurants, especially) that are needed by the tenant's business.

The largest retail centers will probably have an onsite management office to handle the maintenance of the property and to work closely with the tenants. The best known and wealthiest tenants that occupy the largest space in a retail shopping mall are called **anchor tenants**. These tenants (examples include "Big Box"-type retailers like *Walmart* and *Target*) may be the main reason why a customer drives into a mall's parking lot in the first place. Other tenants who operate restaurants, candy stores, and bookstores will likely benefit from the increased traffic in the center because a customer will usually visit more than one store each time they enter a mall.

Office buildings: An office building is generally classified within three categories or class ranges - Class A, B, or C. Prime Class A properties are the most prestigious and valuable properties to own or lease partly because they typically have exceptional traffic from daily visitors in busy metropolitan areas, such as downtown San Francisco, Los Angeles, or San Diego. Class B properties are not as nice or new as most Class A

properties and they are usually considered “average” properties. Class C properties are the oldest and most rundown properties with the least amount of traffic.

The rents paid by tenants in a Class A, B, or C property can vary widely from a fixed rental payment option that never changes for older Class C properties to rental payments that include some combination of a fixed base rent plus a percentage of the landlord’s overall expenses. Those expenses may include maintaining the common areas such as landscaping, parking, the building’s lobby, and public restrooms, as well as covering the landlord’s overall monthly costs related to property insurance and taxes. These costs are assessed to the tenant based upon how much space in the building the tenant is leasing. If the tenant leases 20% of the building’s space, then that tenant may pay a fixed monthly base rent plus one or more additional expenses (e.g., a 20% share of the overall building’s cost) for the property taxes, insurance, and/or common area maintenance.

A commercial lease agreement for an office building might be structured in one of a few different ways if there is a fixed monthly base rent plus a portion of one or more prorated expenses. Let’s base it on the tenant occupying that 20% share of the building:

A **single-net** lease agreement is generally a fixed monthly rent amount plus one additional prorated landlord expense (e.g., 20% of the property tax costs). An older Class B or C property might have a lease agreement like this one.



A **double-net** lease requires that the tenant pay two additional expenses each month over and above the fixed base rent (e.g., 20% of the property tax and insurance costs). A Class B or almost Class A property may have a lease agreement like the double-net.

A **triple net** lease (also known as a “net-net-net” or NNN lease) requires that the tenant pay a fixed monthly base rent in addition to a prorated share (e.g., 20%) of the property taxes, insurance, and common area maintenance fees. The best and brightest properties in prime locations such as downtown Los Angeles or San Francisco will likely have triple-net lease agreements.

Industrial properties: Industrial properties usually have the longest lease terms of all property types. Some of the best known industrial properties include warehouses, manufacturing plants, and distribution centers. Companies like *Amazon*, for example, may need warehouses and distribution centers that are the size of 17 football fields to accommodate

their high volume of consumer goods. Close proximity to major transportation hubs or centers (airports, shipyards, and train stations) can make the property location incredibly valuable to the owner and the tenant.

Because landlords might need to add hundreds of thousands or even millions of dollars of tenant improvements to their property for their biggest customers, most lease terms for industrial properties can range from five or ten years up to twenty years or longer. A real estate agent who handles the signing of a very long-term lease can make a commission that is well over \$100,000 or more for just introducing the tenant to the landlord. Often, the tenant will not need any onsite management to assist them since they take up 100% of the space and have hundreds of their own personnel to assist them with their daily needs.

Professional Property Management

The **Institute of Real Estate Management (IREM)** was formed back in 1933, as a subdivision of the NAR (National Association of Realtors) during the depths of the Great Depression to improve the licensing and management standards for property management personnel. The intent was to stop the commingling of collected rental funds with manager's funds, require that all employees who handle funds must be bonded, and improve the disclosure requirements related to all fees, commissions, and other payments made to agents or other third parties.

Five years later in 1938, the **Certified Property Manager** license designation was created as a way to certify or confirm that a licensed property manager was in fact fully qualified to act in this profession. Over the next several decades, more and more property management designations were offered for qualified agents such as the **Accredited Resident Manager (ARM)** and the **Accredited Management Organization (AMO)** for the licensed individual and management firm, respectively.

The more qualifications and license endorsements that a person has in the field of property management today, the more likely the agent will have multiple jobs to choose from as either an **individual property manager** handling just one rental property for a client, or as a **resident manager** who is directly employed by the owner or the supervising management company.

The first step for agents to take in the property management field is to sign a property management agreement with the landlord or tenant applicant who is seeking a specific property for their family or business. A management agreement will create an agency relationship between the licensed professional and his or her principals (landlord or tenant). Because a property management agreement is considered a type of agency agreement, it must be in writing and signed by both parties. It must also state:

- the term of the agency;
- the agent's scope of designated authority;
- the amount of compensation to be paid to the agent; and
- the property's description.

For lease agreements when the agent is representing the tenant who is seeking to lease a new property for his business (a commercial property transaction), the agent should ask the tenant to write down their desired property types and locations somewhere within their agency agreement or elsewhere. In regard to an agent's authority or expected duties, where the principal is a landlord, the agent should get clarity from his principal as to whether the agent will be expected to personally collect the rent checks, place the ads to find new tenants, handle phone calls, and assist with the signing of the lease agreements.

The property manager might be compensated by way of a fixed monthly salary, a percentage of gross income, a commission or bonus for new rentals and/or low vacancy rates, or some combination of all of these fee options. The compensation should be stated clearly in the property

management agreement so that there are no financial disputes later on.

The landlord may require the property manager to handle some or all of the functions listed below when working on larger residential or commercial property sites:

- create and place ads in newspapers and online;
- place signs around the property;
- handle direct mail marketing;
- collect deposits and rents;
- forward the collected deposits and rents to the landlord's bank account or to his designated financial advisor;
- act as a bookkeeper to keep track of monthly income and expenses;
- deal with any tenant complaints;
- set up appointments with handymen to fix any needed repairs;
- meet with tenants to sign the lease agreements; and
- work with the landlord's attorneys, court representatives, or the sheriff's department to handle any evictions.

Management Risks

There are a number of potential risks that a licensed agent or onsite property manager can face each year with the showing of one rental unit or when operating as the manager for a much larger apartment building. These risks may include personal safety issues, financial liabilities due to the handling of large amounts of funds, and licensure risks if the agent does not follow the guidelines presented by CalDRE or various state laws.



These risks for licensees may include the following:

- 1) An agent may be robbed by someone, especially if they collect large amounts of cash from tenants. In addition, an agent may be raped, assaulted, or even murdered when showing a vacant apartment unit or home far away from neighboring homes. It is advisable for the agent to bring someone along when showing properties, if possible. If not, the agent should let other business associates know where they are scheduled to be at their next appointment.
- 2) An agent must have a signed property management agreement in place when working with clients. This is true even for situations where the agent is just showing a friend's place for free to a prospective tenant. If that same tenant is later evicted, he or she may file a lawsuit against the agent, regardless of whether the agent collected any commission.

3) Agents should use CalDRE lease forms or other professional lease agreements. A handwritten lease agreement that does not include enough or the proper provisions to protect the agent could be a serious problem for the agent if he or she later ends up in a lawsuit.

4) Agents who do not deposit the tenants' security deposits or rents in the correct trust-fund account for the landlord in the shortest amount of time possible may be faced with civil litigation and licensure suspensions.

5) Agents who do not balance the financial books accurately when given this task as a property manager may get into trouble with an unhappy landlord who thought that the latest month's income was going to be positive rather than negative.

6) Property managers should ask their new tenants to sign some type of a **move-in** and **move-out** form each time they are about to begin and end their lease term. This way, both the leasing agent and tenant can share and compare their checklists as it pertains to the condition of the property. Without these forms, the tenant may later say that the hole in the bathroom wall was there before the tenant moved in even though the leasing agent was 100% certain that it was not.

Accounting and Bookkeeping

For the landlord, the most important part of the relationship with his tenant(s) is the receipt of consistent rental checks as required by the signed lease agreement. Some owners will hire outside bookkeepers or large accounting firms to handle their financial books while other landlords will ask the property manager to handle the collection of rents and the payment of expenses while keeping their records as accurate as possible.

Each month, the property manager, bookkeeper, or accountant may send the property owner a detailed monthly **statement of operations**. The monthly statement usually includes a summary of operations, a rent roll, a list of monthly expenses and disbursements paid, and a more detailed narrative letter or report about the overall status of the property.

Rent roll: This is a summary or register of all rents collected for the month along with the names of each tenant and their contact information. The list will include both occupied units that generated actual income, occupied units with tenants who did not pay their rent on time, and vacant units that had zero income for the month. The rent roll is generally created as a ledger or spreadsheet and includes previous balances, current rents collected, and any outstanding rents yet to be collected.

Statement of owner disbursements: This is a list that will show all of the expenses paid out by the property manager on behalf of the owner. The licensed agent should include copies of all original bills, paid receipts, and copies of the checks used to pay the bills. The manager is likely to break down the expenses paid into separate categories so that it is easier to read. The categories may include: cleaning services, carpets and flooring, utilities, taxes and insurance, and advertising expenses. At the end of the year, these income and expense lists and spreadsheets can be forwarded to the owner and his accounting firm for the preparation of income tax forms.

The property manager should consider including some type of a **narrative or cover letter** to go along with each mailed or personally delivered summary of operations statement. During months when the monthly cash flow went from plus \$1,000 down to negative \$200 for an individual home being leased, the property manager can explain in depth why that occurred. The busy owner may have forgotten that the property manager had told him or her about the leaky pipes that had to be fixed for the tenant's basement, or that they risked a serious flood and mold problem that could have cost the landlord tens of thousands of dollars in damage.

For much larger apartment buildings that are owned by landlords who live far away from the property site, a detailed narrative letter can be quite helpful with each month's income and expense numbers sent out to the client. The licensed agent may wish to include photographs of any damaged areas that were repaired (both before and after photos) and copies of letters of thanks from the grateful tenant for making the repairs so quickly as requested. Agents who give owners their personal touch by offering them detailed cover letters that explain the latest good and bad news for the property are agents who are likelier to remain on the job for many years to come.

Landlords may appreciate phone calls from their onsite property managers or licensed agents in addition to the latest income and expense reports that are mailed out. On these phone calls and/or in the agent's narrative letters, the agent can let the owner know about the latest rent and value price trends, overall vacancy rates for the region, the most-recent unemployment rates for the area, and share new details about the latest school, park, or new employment center being built that could help both the property manager and landlord find new tenants.

Property management and the rest of the real estate field is more of a "people business" than a property business. Any licensee who works in one or more sides of the real estate profession should keep in mind that the agent must work primarily on behalf of the client's main needs and interests while continually keeping them informed and educated about the latest property trends, risks, and opportunities. Misrepresentation and silence is not so golden here in the Golden State, so licensees should do their best to keep the lines of communication open as much as possible.

Chapter Twelve Summary

- California is home to some of the most expensive real estate in the world to either purchase or lease. Some rental units lease at prices up to \$10 per square foot while some homes sell for \$1,000 to \$1,500 per square foot near certain prestigious coastal areas.
- It can be cheaper for many California residents to buy a home with little money down and an FHA mortgage than to lease an apartment unit. Agents should try to reach out to tenants paying prices that are equal to or greater than potential mortgage payments may be in the region.
- The ownership of property over a long period of time can create the bulk of a person's overall net worth. *Time + Appreciation + Debt Amortization = Solid Equity & Net Worth*
- The **lessor** in a lease contract is the owner or landlord, the **lessee** is the tenant or renter, and the licensed property manager is the **agent**.
- **Estate for years:** A lease with a definite start and end date. The lease term can be for less than a year or for several years. The lease may be terminated early without penalty by mutual agreement.
- **Estate from period to period:** A lease agreement that continues for periods of time (also referred to as a **periodic tenancy**) such as month-to-month or year-to-year. Most apartment leases have month-to-month terms.
- **Implied warranty of habitability:** Landlords are expected to offer rental units or properties that are livable or habitable for human occupancy. If not, the tenant may have the legal right to pay

discounted rental prices or terminate the lease early without penalty.

- **Sublease:** The **lessor** is the landlord, the **lessee** is the original tenant, and the **sublessee** is the new tenant who took over the leasehold interests from the lessee. The lessee may also be described as holding a *sandwich lease* between the landlord and sublessee. The sublessee typically pays rent to the lessee, who then pays the lessor.
- The **Protecting Tenants at Foreclosure Act (Tenants Protection Act)** was passed in 2009 to protect tenants living in properties that were foreclosed upon as long as the properties had federally-related mortgage loans secured by residential properties (such as an FHA loan). The foreclosing banks or third-party investors had to honor the existing leases in most cases after taking title to the property. An exclusion to this rule was an investor who planned to move into the home. If so, the investor would still need to give the tenant 90 days' notice to vacate.
- To legally evict a tenant, a landlord will usually send the tenant a **three-day notice to pay or quit**, request an **unlawful detainer** in court, and then ask for a **writ of possession** that will be handed to a sheriff. If the tenant will not willingly move out after being asked, the sheriff or his deputies may physically remove the tenant from the premises.
- Commercial tenants can pay a combination of a fixed monthly rent payment plus one, two, or three additional prorated shares of the owner's monthly expenses for the tenant's space. This includes expenses such as property taxes, insurance, and common area maintenance. The leases are called **single-net**, **double-net**, and **triple-net** agreements depending on how many of the expenses the tenant must pay.

A licensed real estate agent can act as an **individual property manager** handling just one rental property for a client, or as a **resident manager** who is directly employed by the owner or the supervising management company.

Chapter Twelve Quiz

1. What percentage of a tenant's median income in San Francisco will go towards their monthly rental expenses?
 - A. 25%
 - B. 33%
 - C. 42%
 - D. 50%

 2. Which investment return category provides owners with lowest cash down options?
 - A. Appreciation
 - B. Leverage
 - C. Cash Flow
 - D. Debt-to-income ratios

 3. Which leasehold interest has a definite starting and ending date that *may* be for less than a year?
 - A. Periodic tenancy
 - B. Joint tenancy
 - C. Estate at sufferance
 - D. Estate for years

 4. The most common lease agreement offered by large apartment buildings is _____.
 - A. Estate at will
 - B. Periodic tenancy
 - C. Estate for years
 - D. Beneficial tenancy
-

5. The type of lease agreement when a tenant continues to live in a property well after the signed lease term has expired is _____.
A. A lease default
B. Estate at sufferance
C. Estate at will
D. Estate for years
6. What is the maximum amount of a security deposit that a landlord may collect upfront from a new tenant for an unfurnished unit?
A. One month's rent
B. One month's rent plus \$500
C. Two months' rent
D. Three months' rent
7. What is the maximum amount of a security deposit that a landlord may collect upfront from a new tenant for a furnished unit?
A. One month's rent plus \$1,000
B. Two months' rent
C. Two months' rent plus \$1,000
D. Three months' rent
8. The tenant transfers 100% of their rights and interests in the property to a new third party with _____.
A. A sublease
B. An assignment
C. An amendment
D. A novation
9. A sandwich lease interest is part of _____.
A. An original lease
B. A modification
C. A sublease
D. A conversion

10. Which action usually happens first during the eviction process?
- A. Landlord's warning letter
 - B. Three-day notice to pay or quit
 - C. Unlawful detainer
 - D. Writ of possession
11. An anchor tenant is most likely to be found in a(n) ____.
- A. Apartment building
 - B. Retail shopping center
 - C. Land site
 - D. Fourplex
12. Which building category will usually have the highest rents?
- A. Class A
 - B. Class B
 - C. Class C
 - D. Triple Net

Answer Key:

1. D	6. C	11. B
2. B	7. D	12. A
3. D	8. B	
4. B	9. C	
5. B	10. A	

GLOSSARY

Abandonment: Giving up possession or ownership of property by not using it, generally indicated through some affirmative act, like removing one's belongings from an apartment.

Abstract of judgment: Document that summarizes the result of a legal action, which can be filed in any county where the judgment debtor owns a property.

Abstract of title: Summation of all recorded transfers, conveyances, legal proceedings, and any other facts relied on as evidence of title to show ownership continuity and signify any possible loss to title.

Acceleration clause: Provision in a real estate financing instrument allowing the lender to declare the full debt due immediately if the borrower breaches any of the provisions of the loan agreement. Also referred to as a call provision.

Acceptance: (a) Agree to the terms of an offer to enter into a binding contract. (b) Receive delivery of a deed from the grantor.

Accession: The process of manufactured or natural improvement or addition to property.

Accretion: A steady addition to dry land through the forces of nature, as when waterborne sediments get deposited on waterfront property.

Acknowledgment: Formal declaration made before an authorized person (generally a notary public) by an individual who has executed a written instrument that it has been done voluntarily.

Acquisition cost: Amount of money required to acquire title to a property; it includes the purchase price as well as the closing costs, legal fees, escrow, service charges, title insurance, recording fees, and other such expenses.

Acre: Area of land measuring 160 square rods, 4,840 square yards, or

43,560 square feet; a tract of about 208.71 feet square.

Actual age: Number of years since a building was completed; also called *historical* or *chronological* age.

Actual authority: Authority actually given to an agent by the principal (expressly or by implication).

Actual eviction: Forcing someone physically off real property or preventing someone from re-entering property or using legal action to make someone leave the premises.

ADA: Americans with Disabilities Act.

Addendum: A page containing additional provisions attached to a purchase agreement or any other contract.

Adjacent: Next to, nearby, bordering, or neighboring (not necessarily in real contact).

Adjustable-rate mortgage (ARM): Loan in which the interest rate increases or decreases to reflect changes in cost of money.

Adjusted basis: Purchase price of property plus cost of specified improvements, minus any depreciation deductions taken.

Adjustment period: Time period between when the interest rate or monthly payment for an adjustable-rate mortgage is changed.

Administrative agency: Government body administering a complicated area of law and policy, implementing and enforcing detailed regulations that have the force of law. For example, the Bureau of Real Estate is the administrative agency charged with regulating the real estate business.

Administrator: Individual appointed by the probate court to manage and distribute the estate of a deceased person if no executor is named in the will or there is no will.

Ad valorem: Latin phrase meaning “according to value,” referring to

taxes assessed on the value of property.

Adverse possession: A way of acquiring title to real property belonging to someone else by occupying it without permission, and fulfilling other statutory requirements.

Affidavit: Acknowledged sworn statement in writing made before a notary public (or any other official authorized to administer an oath).

Affiliated licensee: A real estate salesperson or associate broker employed by a broker.

Affirm: (a) To confirm or approve. (b) To make a sincere declaration that is not under oath.

After-acquired title: If a title is acquired by a grantor, only after a conveyance to a grantee, the deed to the grantee becomes effective at the time the grantor actually receives title.

Age of majority: Age of a person when he or she becomes legally competent (usually 18 years old).

Agency: The association between a principal and the agent of the principal that is formed by way of a contract—may be oral or written, express or implied—through which the agent is employed by the principal to do certain acts dealing with a third party.

Agency, Apparent: When the impression given to a third party is that someone who hasn't been approved to represent another is that person's agent, or the impression that an agent has been approved to perform acts which are actually beyond the capacity of his authority; also called *ostensible agency*.

Agency, Dual: An agency relationship where the agent represents two principals in their dealings with each other.

Agency, Exclusive: Listing agreement that employs a broker as sole agent for a seller of real property for which the broker is entitled to compensation if the property is sold via any other broker, but not if a sale is negotiated by the owner without the services of an agent.

Agency, Ostensible: *See* Apparent agency

Agency confirmation statement: Written statement indicating the representation of a real estate agent of a party. It should be signed by both the buyer and the seller before they enter into a residential purchase agreement.

Agency disclosure form: Form explaining the duties of a seller's agent, a buyer's agent, and a dual agent—required to be signed by both the buyer and the seller before they enter into a residential purchase agreement.

Agency law: Body of legal rules governing the relationship between agent and principal by imposing fiduciary duties on the agent as well as liability for the actions of the agent on the principal.

Agent: Individual authorized to represent another (known as the principal) in dealings with third parties.

Agents in production: Elements necessary to generate income and establish a value in real estate: labor, coordination, capital, and land.

Agreement: Contract between two or more persons to do or not do a certain thing, for consideration.

Air rights: The right to unobstructed use and possession of the airspace over a parcel of land. This right may be transferred separately from the land.

Alienation: The transfer of ownership or an interest in property from one person to another, in any way.

Alienation, Involuntary: Transfer of an interest in property against the will of the owner, or without any action by the owner (ensuing through operation of law, natural processes, or adverse possession).

Alienation, Voluntary: When an interest in property is voluntarily transferred by the owner to someone else (generally by deed or will).

Alienation clause: A security instrument provision giving the lender the right to declare the full loan balance due immediately if the borrower sells or transfers the security property; also termed as due-on-sale clause.

Alluvion: Increase of soil along the banks of a body of water by natural forces.

Alquist-Priolo Act: A law in California that requires applications for development of property in an earthquake-fault zone to include a geologic report.

ALTA: American Land Title Association is a nationwide organization of title insurance companies. An extended coverage title policy is also referred to as an ALTA policy.

Amendment: A supplementary agreement that changes one or more terms of a contract is a contract amendment or contract modification. It must be signed by all the parties to the original contract.

Amenities: The features of a property that adds to the pleasure/convenience of owning it, such as a swimming pool, a beautiful view, a gym, and so on.

Americans with Disabilities Act: Federal law mandating that public facilities must be accessible to disabled people.

Amortization, Negative: The adding of interest-not-paid to the principal balance of a loan.

Amortize: To pay off a debt gradually with installments that include both principal and interest.

Annexation: When personal property is attached to real property, so that the personal property becomes part of the real property by law.

Annexation, Actual: Physically attaching personal property to real property, so that it can be made a part of the real property.

Annexation, Constructive: Associating personal property with real

property so it is treated as a fixture by law, although not attached physically. Example: jewelry is constructively annexed to a house.

Annual percentage rate (APR): All the charges paid by the borrower for the loan (including the interest, origination fee, discount points, and mortgage insurance costs), expressed as an annual percentage of the amount borrowed.

Annuity: Sum of money received in a series of payments at regular intervals (usually annually).

Anticipation, Principle of: In appraisal, when value is created by the expectation of benefits to be obtained in the future.

Anticipatory repudiation: Action taken by one party to a contract to inform the other party, before the time set for performance, that he does not intend to fulfill the contract.

Anti-deficiency rules: Laws prohibiting a secured lender from suing the borrower for a deficiency judgment in certain circumstances.

Apportionment: A division of property or liability into proportionate parts (may not be equal parts).

Appraisal: An estimate or opinion of the value of a piece of property as of a specific date.

Appraiser: Person who evaluates the value of the property, especially a trained and experienced person who has expertise in this field.

Appraiser, Fee: A self-employed appraiser hired to appraise real estate for a fee, as opposed to an appraiser who works for a lender, a government agency, or some other entity as a salaried employee.

Appreciation: An increase in value; the opposite of depreciation.

Appropriation: Keeping property or reducing it to a personal possession, excluding others from it.

Appropriative rights: A person's rights to a water appropriation permit.

Appropriative rights system: A water-rights allocation system, in which a person wanting to make use of water from a certain body of water (like a river or lake) is supposed to have a permit. A permit that is issued earlier has precedence over a newer permit. This is also called the prior appropriation system.

Appurtenances: Rights that go along with ownership of a particular piece of property, such as air rights or mineral rights. These are generally transferred with the property, but in some cases they may be sold separately.

Appurtenances, Intangible: Rights concerning ownership of a piece of property that does not comprise physical objects or substances. An access easement is a good example of this.

APR: See Annual percentage rate (APR)

Area: (a) Locale or region. (b) The size of a surface, normally in square units of measure, as in square feet or square miles.

ARM: See Adjustable-rate mortgage

Arm's length transaction: Transaction where there is no family relationship, friendship, or pre-existing business relationship between two parties.

Arranger of credit: Real estate licensee or attorney who arranges a transaction for credit to be extended by seller of residential property.

Artificial person: A legal unit, such as a corporation, treated as an individual having legal rights and responsibilities by the law; as distinguished from a human being. An artificial person is also called a legal person.

Assemblage: Merging two or more adjoining properties into one expanse.

Assessment: Property valuation for taxation purposes.

Assessor: Officer responsible for determining the value of the property for taxation.

Asset: A thing of value owned by a person.

Assets, Capital: Assets that a taxpayer holds, other than (a) property held for sale to customers, and (b) depreciable property or real property used in the taxpayer's trade or business. Real property is a capital asset if it is used for personal use or for profit.

Assets, Liquid: Any assets or cash that can be turned into cash (liquidated), such as stock in a company.

Assets, Section 1231: Properties used in a trade or business or held for the production of income (it is referred to as Section 1231 in the federal income-tax code).

Assign: Transfer of rights (particularly contract rights) or interests to another.

Assignee: One to whom rights or interests are assigned.

Assignment: (a) Transferring contract rights from one person to another. (b) In case of a lease, the transfer of the entire leasehold estate by the original tenant to another.

Assignment of contract and deed: The instrument through which a new vendor is substituted for the original vendor in a land contract.

Assignor: Someone who assigns his rights or interest to another.

Assumption: Action by a buyer to take on personal liability for paying off the seller's existing mortgage or deed of trust.

Assumption fee: A fee paid to the lender, generally by the buyer, when a mortgage or deed of trust is assumed.

Attachment: Court-ordered seizure of property belonging to a defendant in a lawsuit, so it will be available to satisfy a judgment if the plaintiff wins. An attachment creates a lien in case it is real property.

Attestation: The act of witnessing the execution of an instrument, such as a deed or a will.

Attorney General: The principal legal advisor for state government, including legal advisor to the Department of Real Estate on matters regarding the Real Estate Law.

Attorney in Fact: Someone who is authorized to represent another by a power of attorney, not necessarily a lawyer.

Attractive nuisance: A dangerous feature appealing to children, thus posing a potential source of liability for the property owner.

Auditing: Verifying and examining records, particularly the financial accounts of a business or other organization.

Avulsion: (a) A sudden (not slow) tearing away of land by the action of water. (b) A sudden shift in a water course.

Bad debt/vacancy factor: A percentage deducted from a property's potential gross income to find the effective gross income, estimating the income that will probably be lost due to vacancies and non-payment of rents by the tenants.

Balance, Principle of: An appraisal principle which holds that the maximum value of real estate is achieved when the agents in production (labor, capital, land, and coordination) are in proper balance.

Balloon payment: A payment on a loan (usually the final payment) that is substantially larger than the regular installment payments.

Bankruptcy: (a) A condition resulting when the liabilities of an individual, corporation, or firm exceeds assets. (b) A court declaration that an individual, corporation, or firm is insolvent, resulting in the assets and debts being administered under bankruptcy laws.

Barter: To exchange or trade one commodity or piece of property for another without the use of money.

Base line: Main east-west line in the government survey system from which township lines are established. Each principal meridian has one base line associated with it.

Basis: Figure used in calculating the gain on the sale of real estate for federal income-tax purposes; also called the cost basis.

Basis, Adjusted: The initial basis of the owner in the property, plus capital expenditures for improvements and minus any allowable depreciation deductions.

Basis, Initial: The amount of the owner's original investment in the property—the cost of acquiring the property including closing costs and other expenses along with the purchase price.

Bearer: A person in possession of a negotiable instrument.

Bench mark: A surveyor's mark at a known point of elevation on a stationery object, used as a reference point in calculating other elevations in a surveyed area, most often a metal disk set into cement or rock.

Beneficiary: (a) One for whom a trust is created and on whose behalf the trustee administers the trust. (b) The lender in a deed of trust transaction. (c) Someone who is entitled to receive real or personal property under a will (a legatee or devisee).

Beneficiary's statement: Document in which a lender confirms the status of a loan (the interest rate, principal balance, etc.) and describes any claims that could affect an interested party.

Bequeath: To transfer personal property to someone by will.

Bequest: Personal property (including money) that is transferred by will.

Betterment: An improvement to real property that is more extensive than ordinary repair or replacement which increases the value of the property.

Bilateral contract: Contract under which each party promises performance.

Bill of sale: A document used to transfer title to personal property from a seller to a buyer.

Blanket mortgage: Mortgage that includes more than one property parcel as security.

Blind ad: An advertisement placed by a real estate licensee that does not indicate the ad is from a licensee.

Block: A group of lots surrounded by streets or unimproved land in a subdivision.

Blockbusting: Attempting to lure owners to list or sell their homes by predicting that the members of another race or ethnic group, or people suffering from some disability, will be moving into the neighborhood—also called “panic selling.” It is a violation of antidiscrimination laws.

Blue sky laws: Laws regulating the promotion and sale of securities in order to protect the public from fraud.

Board of directors: The body responsible for governing a corporation on behalf of shareholders.

Bona fide: In good faith; genuine, not fraudulent.

Bond: (a) A written obligation, normally interest bearing, to pay a certain sum at a specified time. (b) Money put up as a surety, protecting against failure to perform, negligent performance, or fraud.

Bonus: An additional payment over and above the due payment.

Boot: Something given or received in a tax-free exchange, which is not like-kind property. For instance, in an exchange of real property where one party gives another party cash in addition to real property, the cash is the boot.

Boundary: The perimeter or border of a parcel of land; the dividing line between two pieces of property.

Branch manager: An associate broker appointed by a firm’s primary broker to manage the operations of a branch office.

Breach: Violation of an obligation, duty, or law.

Breach of contract: Failure to perform a contractual obligation.

Broker, Associate: Someone who is qualified as a broker and is affiliated with another broker.

Broker, Cooperating: A broker belonging to a multiple listing service who helps sell a property listed with another member of the listing services.

Broker, Designated: A corporate officer or a general partner who is authorized to act as the broker for a licensed corporation or for a partnership.

Broker, Fee: A real estate broker who—in violation of the license law—allows the use of his license to another person to carry on a brokerage.

Broker, Listing: A broker having a listing agreement with a property seller.

Broker, Real estate: Someone who is licensed to represent members of the public in real estate transactions in exchange for compensation.

Brokerage: Business of a real estate broker.

Brokerage fee: Service charges of a real estate broker that is paid as a commission or as other compensation.

Buffer: Undeveloped area that separates two areas zoned for incompatible uses.

Building codes: Regulations that set minimum standards for construction methods and materials.

Building restrictions: These are rules that apply to building size, type, or placement. They may be public restrictions, such as zoning ordinances or private restrictions (e.g., CC&Rs).

Bulk transfer: The sale of all or a substantial part of the merchandise, equipment, or any other inventory of a business that is not in the

ordinary course of business.

Bulk transfer law: A law that requires a seller who negotiates a bulk transfer (generally connected with the sale of the business itself) to furnish the buyer with a list of creditors and a schedule of the property being sold, and to notify creditors of the impending transfer.

Bump clause: A provision in a purchase agreement allowing a seller to keep the property on the market while waiting for a contingency clause to be fulfilled. In the meantime, if the seller receives another good offer, he can ask the buyer either to waive the contingency clause or terminate the contract.

Bundle of rights: The rights inherent in ownership of property, including the right to use, lease, enjoy, encumber, will, sell, or do nothing with the property.

Bureau of Real Estate: The BRE administers the Real Estate Law of California, as well as the licensing of real estate brokers and salesperson.

Business opportunity: A business that is for sale.

Buy down: Discount points paid to a lender to reduce (buy down) the interest rates charged to a borrower, especially when a seller pays discount points to help the buyer (borrower) qualify for financing.

Buyer representation agreement: A contract in which a prospective buyer hires a real estate broker to act as his agent for locating desirable property and negotiating its purchase, or in negotiating the purchase of a property that the buyer has already found. This is also called the buyer agency agreement.

California Coastal Act: Law that is designed to protect and control development along the California coastline.

California Fair Housing Law: Law that guarantees equal treatment for everyone in all business establishments; often referred to as the Rumford Act.

California Veterans Farm and Home Purchase Program: State-sponsored residential finance program utilized to provide cheap home and farm loans to veterans; often called the “Cal-Vet program.”

Call: A specification that describes a segment of the boundary in a metes and bounds description; for example, “South 20°, west 100 feet” is a call.

Cancellation clause: Terminating a contract without undoing acts that have already been performed under the contract.

Cap: A limit on how much a lender may raise an adjustable-rate-mortgage interest rate or monthly payment—per year, or over the life of the loan.

Capacity: The legal ability or competency to perform any act, such as enter a binding contract (contractual capacity) or execute a valid will (testamentary capacity).

Capital: Money or other forms of wealth available for use in producing more money.

Capital assets: Assets held by a taxpayer other than property held for sale to customers in the normal course of the taxpayer’s business; it also comprises depreciable property or real property used in the taxpayer’s trade or business. Therefore, real property is a capital asset if owned for personal use or for profit.

Capital expenditures: Money spent on improvements and alterations that add to the value of the property and/or prolong its life.

Capital gain: Profit achieved from the sale of a capital asset. It is a long-term capital gain if the asset was held for more than one year, and it is a short-term capital gain if the asset was held for one year or less.

Capital improvement: Any improvement designed so that it becomes a permanent part of the real property or that will have the effect of prolonging the property’s life significantly.

Capitalization: A method of appraising real property by converting the

anticipated net income from the property into the present value; also called the income approach to value.

Capitalization rate: A percentage used in capitalization ($\text{Net Income} = \text{Capitalization Rate} \times \text{Value}$). It is the rate believed to represent the proper relationship between the value of the property and the income it produces; the rate that would be a reasonable return on an investment of the type in question; or the yield necessary to attract investment of capital in property like the subject property. It is also called the cap rate.

Capital loss: A loss that is a result of a sale of a capital asset. It may either be long-term (held for more than one year) or short-term (held for one year or less).

Capture, Rule of: Legal rule that grants a land owner the right to all oil and gas produced from wells on his land, even if it migrated underneath from land that belongs to someone else.

CAR: California Association of Realtors®.

Carryback loan: See Purchase money mortgage

Cash flow: Residual income after deducting all operating expenses and debt service from gross income.

Cash on cash: The ratio between cash received in the first year and cash initially invested.

CC&R: A declaration of covenants, conditions, and restrictions that is generally recorded by a developer to place restrictions on all lots within a new subdivision.

CEQA: California Environmental Quality Act.

CERCLA: Comprehensive Environmental Response, Compensation, and Liability Act.

Certificate of discharge: Document given by the mortgagor to the mortgagee when the mortgage debt has been paid in full, acknowledging

that the debt has been paid and the mortgage is no longer a lien against the property; also called a satisfaction of mortgage or mortgage release.

Certificate of eligibility: Document issued by the Department of Veterans Affairs regarding the veteran's eligibility for a VA- guaranteed loan.

Certificate of occupancy: Document issued by a local government agency (such as the building department) verifying that a newly-constructed building is in compliance with all codes and may be occupied.

Certificate of reasonable value (CRV): Based on an appraiser's estimate of the value of a property, it is mandatory in order for a VA- guaranteed home loan to be authorized; the amount of the loan cannot be more than the CRV.

Certificate of sale: Document given to the purchaser at a mortgage foreclosure sale instead of a deed; it is replaced with a sheriff's deed only after the redemption period expires.

Chain of title: Record of encumbrances and conveyances pertaining to a property.

Change, Principle of: An appraisal principle which holds that the future, not the past, is of primary importance in estimating a property's value.

Charter: A written instrument granting a power or a right of franchise.

Chattel: An article of personal property.

Chattel mortgage: Using personal property as security for a debt.

Chattel real: Personal property closely associated with real property. A lease is a good example.

Civil Rights Act of 1866: Federal law guaranteeing all citizens the right to purchase, lease, sell, convey, and inherit property— regardless of race and color.

Civil Rights Act of 1964: Federal law that disallows discrimination on the basis of race, color, national origin, or religion in programs for which the government provides financial assistance.

Client: Someone who employs a broker, lawyer, appraiser, or any other professional. A real estate broker may have clients who are sellers, buyers, landlords, or tenants.

Closing: The last stage of a real estate transaction when the seller receives the purchase money and the buyer receives the deed with the title transferred to him. It may also be called a settlement.

Closing costs: Expenses incurred while transferring real estate in addition to the purchase price.

Closing date: Date on which all the terms of a purchase agreement have to be met, or else the contract is terminated.

Closing statement: Accounting of funds from a real estate purchase, furnished to both seller and buyer.

Cloud on title: A claim, encumbrance, or apparent defect that makes the title to a property unmarketable.

Code of ethics: Set of rules of accepted standards of conduct, reflecting principles of fairness and morality.

Codicil: An addition to or a revision of a will.

Collateral: Anything of value used as security for a debt or obligation.

Collusion: Agreement between two or more persons to defraud another.

Color of title: Appears to be of good title, but in fact, is not.

Commercial bank: Type of financial institution that has traditionally emphasized commercial lending (loans to businesses), and also makes residential mortgage loans.

Commercial paper: Negotiable instruments, such as promissory notes, sold to meet the short-term capital requirements of a business.

Commercial property: Property that is zoned and used for business purposes, such as restaurants and office buildings. Set apart from residential, industrial, and agricultural property.

Commingled funds: Funds received from different sources that are deposited in one account and thus, lose their separate character.

Commingling: Illegally mixing trust funds held on behalf of a client with personal funds.

Commission: (a) Compensation received by a broker for services provided in connection with a real estate transaction (normally a percentage of the sales price). (b) Group of people gathered for a purpose or a function (generally a governmental body, as in a planning commission).

Commitment: A lender's promise to make a loan in real estate finance; loan may be firm or conditional. (A conditional loan is based on fulfillment of certain conditions, such as a satisfactory credit report on the borrower.)

Common elements: Land and improvements in a condominium, planned unit development or other housing development that are owned and used collectively by all the residents, such as parking lots, hallways, and recreational facilities provided for common use.

Common elements, limited: Features outside of dwelling units in condominiums and other developments—reserved for the use of owners of particular units—are also called limited common areas. For example, assigned parking lots.

Common law: Long-established rules of law based on early English law; it usually prevails unless overruled by statutory law.

Community property: In California as well as other community-property states, property jointly owned by a married couple, as distinguished from each spouse's separate property; usually, any property acquired through the labor or skill of either spouse during marriage.

Co-mortgagor: Family member (generally) who accepts responsibilities for the repayment of a mortgage loan—along with the primary borrower—to help the borrower qualify for the loan.

Comparable: In appraisal, a property that is similar to the subject property and which has been sold recently. The sales prices of comparables provide data for estimating the value of the subject property using the sales comparison approach.

Comparative market analysis: Estimate of property value for an appraisal based on indicators from the sale of comparable properties.

Competent: (a) Having a sound mind for the purpose of entering into a contract or executing a legal instrument (mentally competent). (b) Having a sound mind and also having reached the age of majority (legally competent).

Competition, Principle of: Appraisal principle which holds that profits tend to encourage competition, and excess profits tend to result in disastrous competition.

Compliance inspection: For the benefit of a lender, a building inspection done to determine if the building codes, specifications, or conditions established after a prior inspection have been met—before funding a loan.

Comprehensive Environmental Response, Compensation, and Liability Act: A federal law governing liability for environmental cleanup costs.

Condemnation: (a) Taking private property for public use via the government's power of eminent domain. (b) A declaration that a structure is not fit for occupancy and must be closed or demolished.

Condemnation appraisal: An estimate of the value of condemned property to find out the just compensation to be paid to the owner.

Condition: (a) A provision in a contract that makes the parties' rights and obligations depend on the occurrence (or nonoccurrence) of a

particular event; also called a contingency clause. (b) A provision in a deed that makes title-conveying subject to compliance with a particular restriction.

Conditional use permit: Authorization for a land use that would otherwise not be allowed by zoning ordinances.

Condominium: A subdivision that provides an exclusive ownership (fee) interest in the airspace of a particular portion of real property, and an interest in common in a section of that property.

Confirmation of sale: Court approval of a sale of property by an executor, administrator, or guardian.

Conflict of interest: Situation in which an action that would promote the interests of the agent is in conflict with an action that would promote the interests of the principal. In such a situation the agent must inform the principal and offer to retreat.

Conforming loan: Home mortgage loan in which the borrower and real estate conform to Fannie Mae and Freddie Mac guidelines, with a lower interest rate than a non-conforming loan.

Conformity, Principle of: This principle holds that property values are boosted when buildings are similar in design, construction, and age.

Conservation: (a) Preservation of structures or neighborhoods in a healthy condition. (b) Preservation or limited use of natural resources for long-term benefits.

Consideration: Something of value provided to induce entering into a contract: money, personal services, love. Without consideration, a contract is not legally binding.

Construction lien: See Mechanics lien

Consumer Price Index: An index that tracks changes in the cost of goods and services for a typical consumer.

Contiguous: Adjacent, abutting, or in close proximity.

Contingency clause: *See Condition*

Contract: A written or oral agreement to do or not do specified things, in return for consideration.

Contract, Bilateral: A contract by which each party is bound to a promise to perform.

Contract, Executed: A contract whose contractual obligations have been completely performed by all parties.

Contract, Executory: A contract in which one or both the parties have not yet completed their contractual obligations.

Contract, Express: A contract that has been worded, either spoken or written.

Contract, Implied: A contract that has been worded, but is implied by the actions of the parties.

Contract, Land: A contract for the sale of real property in which the buyer (the vendee) pays in installments. The buyer obtains possession of the property immediately while the seller (the vendor) retains legal title until the full price of the property has been paid. It is also called the conditional sales contract, installment sales contract, real estate contract, or contract for deed.

Contract, Oral: A spoken agreement that has not been written down, also called a parol contract.

Contract, Unenforceable: An agreement that a court of law refuses to enforce.

Contract, Unilateral: A contract that is accepted by performance. The offerer promises to perform his side of the bargain if the other party performs, but the other party has not made the same promise.

Contract, Valid: A binding, legally enforceable contract.

Contract, Void: An agreement that is not an enforceable contract, as

there is an absence of a required element (like consideration) or there is a defect of any kind.

Contract, Voidable: A contract that any of the parties involved may negate without liability, due to lack of capacity or a negative factor such as fraud or duress.

Contract for deed: See Land contract

Contract of adhesion: A one-sided contract that is unfair to one of the parties.

Contractual capacity: The legal capacity to enter into a binding contract. A mentally competent person who has attained the age of majority is a person with contractual capacity.

Contribution, Principle of: An appraisal principle which holds that the value of real property is at its best when the improvements produce the highest return proportionate with their cost—the investment.

Conventional loan: Mortgage loan not guaranteed by governmental agency, such as the Veterans Administration.

Conversion: (a) Misappropriating property or funds belonging to another (e.g., converting trust funds to one's own use). (b) The process where an apartment complex is changed to a condominium or cooperative.

Conveyance: Transfer of title of real property from one person to another through a written document (usually a deed).

Cooperating agent: A member of a multiple listing service who finds a buyer for property listed for sale by another broker.

Cooperative: Building owned by a corporation in which the residents are the shareholders. Each shareholder receives a proprietary lease for an individual unit along with the right to use the common areas.

Cooperative sale: A transaction in which the listing agent and the selling agent work together but for different brokers.

Corporation: Legal entity that acts via its board of directors and officers, usually without liability on the part of the person or persons owning it.

Correction lines: Guide meridians running every 24 miles east and west of a meridian, and standard parallels running every 24 miles north and south of a base line, used to correct inaccuracies in the rectangular survey system of land description caused by the earth's curvature.

Cost approach to value: One of the three key methods of appraisal. An estimate of the subject property's value is determined by estimating the cost of replacing the improvements, and deducting the estimated accrued depreciation from it while adding the estimated market value of the land.

Cost basis: *See* Basis

Cost recovery deductions: *See* Depreciation

Counteroffer: Reacting to a contract offer by changing some of the terms of the original offer as a substitute offer.

Covenant: An agreement or a promise to perform or not perform certain acts (generally imposed by deeds). *See* CC&Rs

Covenant, Restrictive: A promise to do or not do acts concerning real property, particularly a promise that concerns land. Most often it is an owner's promise to not use the property in a certain manner.

Covenant against encumbrances: A promise (in a deed) that the property is not weighed down by any encumbrances other than those disclosed in the deed.

Covenant of quiet enjoyment: A promise to not disturb a buyer's or tenant's possession by the previous owner, landlord, or anyone else that makes a lawful claim against the property.

Covenant of right to convey: A promise (in a deed) that the grantor has the legal ability to make a valid conveyance.

Covenant of seisin: A promise (in a deed) by the grantor that he actually owns the interest being conveyed to the grantee.

Covenant of warranty: A promise (in a deed) that the grantor will defend the title of the grantee against claims superior to the grantor's that exist when the conveyance is made.

CPM: A Certified Property Manager has satisfied the requirements set forth by the Institute of Real Estate Management of the National Association of Realtors®.

Credit arranger: A mediator between prospective borrowers and lenders negotiating loans, such as a mortgage broker.

Credit bidding: When the lender obtains a property by bidding the amount the borrower owes in a foreclosure sale.

Credit union: Financial institution that may serve only members of a certain group (as in a labor union or a professional association), and traditionally emphasizes consumer loans.

Cul-de-sac: A dead-end street with a semi-circular turnaround at its end.

Damages: (a) Losses suffered by a person due to a breach of contract or a tort. (b) An amount of money the defendant is ordered to pay to the claimant in a lawsuit.

Damages, Actual: See Compensatory damages

Damages, Compensatory: Damages that are awarded to a claimant as compensation for injuries (personal injuries, property damages, financial losses) caused by the acts of the defendant; also called actual damages.

Damages, Liquidated: Sum agreed upon by the parties in advance, while the contract is being made, to serve as full compensation in case a breach of contract occurs.

Damages, Punitive: An award added to actual damages (in a civil

lawsuit) as a punishment to the defendant for contemptible or malicious conduct, and to discourage others from doing such acts.

Dealer: Someone whose business is to buy and sell real estate.

Dealer property: Property that is held for selling rather than for long-term investment. An example of this would be a developer's inventory of subdivision lots.

Debit: A charge or debt owed to another.

Debtor: Someone who owes money to another.

Decedent: A deceased person.

Declaration of abandonment: An owner-recorded document that voluntarily releases a property from homestead protection.

Declaration of homestead: A recorded document that creates homestead protection for a property that would otherwise not receive it.

Declaration of restrictions: *See* CC&Rs

Decrement: Means a decrease in value, the opposite of increment.

Dedication: Land that is given by its owner for public use and accepted (for that particular use) by the appropriate representative of the government.

Deduction: Amount on which income tax is not required to be paid.

Deed: Correctly executed and delivered written instrument that conveys title to real property (from the grantor to the grantee).

Deed, Administrator's: Deed that an administrator of an estate uses to convey a deceased person's property to his heirs.

Deed, General warranty: Deed by which the title is warranted by the grantor against defects that may have surfaced before or after his tenure of ownership; also called a warranty deed.

Deed, Gift: Deed in which there is no support of valuable consideration,

most frequently listing “love and affection” as the consideration.

Deed, Grant: The most commonly-used type of deed in California, it uses “grant” in its words of conveyance and holds certain implied warranties that the property is not encumbered and has not been deeded to someone else.

Deed, Quitclaim: Deed conveying any interest in the property that a grantor may have at the time of executing the deed, without warranties.

Deed, Tax: A deed that a buyer of a property obtains at a tax foreclosure sale.

Deed, Trustee’s: A deed that a buyer of a property receives at a trustee’s sale.

Deed in lieu of foreclosure: A deed given to the lender by the borrower (who has defaulted) to avoid foreclosure proceedings by the lender.

Deed of reconveyance: Once the debt has been repaid, the security property is released from the lien that is created by a deed of trust. The instrument used is called the deed of reconveyance.

Deed of trust: To secure the repayment of a debt, this instrument is used to create a voluntary lien on real property. This lien includes a power of sale clause that allows non-judicial foreclosure. The parties to this deed are the grantor (borrower), the beneficiary (lender), and the trustee (neutral third party).

Deed restrictions: Provisions in a deed that set restrictions on the use of property. It may either be covenants or conditions.

Default: When one of the parties to a contract fails to fulfill one or more of the obligations or duties as enforced by the contract.

Defeasance clause: There is a clause in a mortgage, deed of trust, or lease which provides for the cancellation of a certain right if a particular event occurs.

Deferred maintenance: Curable depreciations that ensue due to maintenance or repairs that were postponed and thus caused physical deterioration.

Deficiency judgment: Determination by the court that the borrower owes more money when the security for a loan does not completely satisfy a debt default.

Delivery: When a deed is legally transferred from the grantor to the grantee, thus transferring title.

Demand: One of the four elements of value (the other three being scarcity, utility, and transferability). It is a desire to own along with the ability to afford.

Demise: (a) Conveying an interest in real property via the terms of a lease. (b) Transferring an estate or interest in property to someone for a long time period, for life, or at will.

Department of Housing and Urban Development: (HUD) Federal agency responsible for public housing programs, FHA-insured home mortgage loans, and enforcing the Federal Fair Housing Act. The FHA and Ginnie Mae both are a part of HUD.

Depreciable property: In regard to the federal income-tax codes, it is a property that is qualified for depreciation deductions as it might wear out and may have to be replaced.

Depreciation: (a) A loss in value as a result of physical deterioration, functional obsolescence, or external obsolescence. (b) Allocating the cost of an asset over a period of time for the purpose of income-tax deductions.

Descent: When a property is transferred through intestate succession rather than by will. Receiving property by intestate succession is said to be received by descent (not by devise or bequest).

Developer: Someone who subdivides land or improves land to obtain a beneficial use.

Devise: Transferring title to property by will. See Bequest

Devisee: Person who receives title to real property by way of a will.

Devisor: Testator by whom real property is devised by way of his will.

Disaffirm: To request a court to terminate a contract that is voidable.

Disbursements: Money spent out or paid out.

Disclaimer: Denying legal responsibility.

Discount points: Percentage of the principal amount of a loan that is collected by the lender or withheld from the loan amount when the loan is originated. This is done to increase the lender's revenue on the loan.

Discount rate: Interest rate that is charged when a member bank borrows money from the Federal Reserve Bank.

Discrimination: Unequal treatment given to people on the basis of their race, religion, sex, national origin, age, or some other trait.

Disintegration: Period of decline in a property's life cycle when the property's current economic usefulness is ending and constant maintenance becomes inevitable.

Dispossess: Forcing someone out of possession of real property by using legal procedures, as is done in an eviction.

Down payment: Portion of the purchase price of a property that is paid in cash by the buyer, generally the difference between the purchase price and the financed amount.

Downzoning: Rezoning land for limiting its use.

Drainage: Natural or artificial method of removing surface or sub-surface water from an area.

Duress: When someone enters into an agreement as a result of threats of physical violence or mental harassment.

Dwelling: A place of residence; a house or a home.

Earnest money: Deposit made by a real estate buyer demonstrating her good faith.

Easement: Right given to another person or entity to trespass upon property that is not owned by that person or entity.

Easement, Access: An easement that allows the holder of the easement to reach (and leave) his property (which is the dominant tenement) by passing through the servient tenement; also called an easement for ingress and egress.

Easement, Appurtenant: An appurtenant easement is a right to use an adjoining property. The one benefitting from the easement is the dominant tenement.

Easement by express grant: Easement that is voluntarily created in a deed, will, or other written instrument.

Easement by express reservation: When an easement is created in a deed by which the property is divided by the landowner—the servient tenement is transferred while the dominant tenement is retained.

Easement by implication: Easement that is created by law so as to provide access to a landlocked parcel of land.

Easement by necessity: Such an easement is most commonly implied in favor of grantees that do not have any access to their land except over the land owned by the grantor.

Easement in gross: Easement benefitting a person rather than a piece of land. There is a dominant tenant, without a dominant tenement.

Economic life: Time period when an improved property yields a return on investment apart from the rent due for the land itself; also called the useful life.

Economic obsolescence: Loss of value due to factors from beyond the property.

Effective age: Age of a structure as its condition indicates and the remainder of its usefulness (as opposed to its actual age). Effective age of a building may be increased if maintained well.

Ejectment: Legal action through which possession of real property is recovered from someone who has illegally taken possession of it; also called an eviction.

Emblements, Doctrine of: Law allowing an agricultural tenant to enter the land for harvesting the crops even after the lease period ends.

Eminent domain: Right of the government to take title to real property for public use by condemnation. The property owner receives just compensation for property.

Encroachment: Unlawful intrusion onto neighborhood property, often due to a mistake regarding boundary location.

Encumber: Placing a lien or encumbrance against the title to a property.

Encumbrance: Non-possessory interest in real property, such as a mortgage (loan), a lien (voluntary or involuntary), an easement, or a restrictive covenant that limits the title.

Entitlement: In terms of a VA loan, it is the amount of the borrower's guaranty.

EPA: Environmental Protection Agency.

Equal Credit Opportunity Act: Federal law prohibiting lenders from discriminating against loan applicants on the basis of race, color, religion, national origin, sex, marital status, or age—or that the applicant's income is generated from public assistance.

Equitable remedy: Judgment granted by a civil lawsuit to a complainant that is not an award of money/damages which could be an injunction, rescission, or a specific performance.

Equitable right of redemption: Real estate owner's right to take back property after default—but before foreclosure—by paying all debt, costs,

and interest.

Equity: Difference between the current market value of the property and the liens against the property.

Erosion: Process where the surface of the land wears away by the actions of water or wind.

Escalation clause: Provision in a lease agreement that allows an increase in payments on the basis of an increase in an index, such as the consumer price index.

Escheat: Reverting of a property to the state in case there are no capable heirs found.

Escrow: Agreement that a neutral third party will hold something of value (money or a deed) until the provisions of a transaction or a contract may be carried out.

Escrow agent: Neutral third party entrusted by a seller and purchaser to hold something of value pending the fulfillment of conditions needed to close a transaction.

Escrow instructions: Directions that a party to a transaction gives to an escrow agent specifying the terms under which the escrow is to be conducted.

Estate: Interest held by the property owners; it may be a freehold or a leasehold property.

Estate at sufferance: Unlawful occupation of a property by a tenant after their lease has terminated.

Estate at will: Occupancy of real estate by a tenant for an indefinite period, which either party can terminate at will.

Estate of inheritance: Estate that may be passed on to the heirs of the holder, as in a fee simple.

Estate for years: Interest in real property that permits possession for a

set time period.

Estoppel: Legal principle that restricts a party from negating or asserting a certain fact owing to that party's previous actions or statements.

Estoppel certificate: Document that prevents a person who signs it from later asserting facts different from those mentioned in the document; also called an estoppel letter.

Et ux: Abbreviation for the Latin phrase *et uxor* which means "and wife."

Eviction: Dispossession through the process of law.

Eviction, Actual: Forcing someone physically from a property or preventing them from re-entering the real property, or using lawful procedure to make someone leave the premises.

Eviction, Constructive: Act of the landlord that interferes with the tenant's quiet enjoyment of the property to such an extent that the tenant is forced to move out.

Excess land: Part of a parcel of land that does not add to the value of the property.

Exclusive agency listing: Employment contract providing one broker the right to sell a property for a definite period, while also enabling the owner to sell it without having to pay commission.

Exculpatory clause: Provision in a mortgage relieving the borrower of personal liability on the loan (for certain defaults or problems) if the borrower voluntarily surrenders the property to the lender.

Execute: (a) Signing an instrument and taking other steps that may be necessary for validation. (b) To perform or complete.

Executor: Person named in a will to carry out the provisions of the will; also called a personal representative.

Executed contract: Contract for which all terms and conditions

have been completed, making it legally enforceable.

Exemption: Provision by which a law or a rule is not applicable to a certain group or person.

Expenses, Fixed: Recurring property expenses such as real estate taxes or hazard insurance.

Expenses, Maintenance: Cost of cleaning, supplies, utilities, tenant services, and other administrative costs for properties that produce income.

Express: Spoken or written words.

Fair Employment and Housing Act: Civil rights law in California prohibiting all housing discrimination on the basis of race, color, religion, sex, marital status, national origin, sexual orientation, familial status, source of income, or disability; also called the Rumford Act.

Fair Housing Act: Also called Title VIII of the Civil Rights Act of 1968; federal law that makes discrimination illegal on the basis of race, color, religion, sex, marital status, national origin, sexual orientation, familial status, source of income, or disability for the purpose of sale or rental of residential property (or just land that may be used for constructing a residential building).

Federal Deposit Insurance Corporation (FDIC): Federal agency that insures accounts in savings and loans and commercial banks, bolstering confidence in the banking system.

Federal Home Loan Bank System (FHLB): Twelve regional wholesale banks that loan funds to FHLB members to bolster local community lenders.

Federal Home Loan Mortgage Corporation (FHLMC) (Freddie Mac): Federally-sponsored agency that buys mortgages on the secondary market, then bundles and sells them to investors.

Federal Housing Administration (FHA): Federal agency that insures lenders for the repayment of real estate loans.

Federal National Mortgage Association (FNMA) (Fannie Mae): Federally-sponsored agency that buys and sells residential mortgages, thereby enhancing liquidity in the mortgage market.

Federal Reserve (the Fed): Government body that regulates commercial banks and implements monetary policy in order to stabilize the national economy.

Federal Reserve System: Twelve Federal Reserve Banks which make loans to member banks.

Federal Trade Commission (FTC): Federal agency with the responsibility for investigating and terminating unfair and misleading business practices; enforces the Truth in Lending Act.

Fee: *See* Fee Simple

Fee simple: Recognized as the highest form of estate ownership in real estate. Duration of this ownership is unlimited and can be conveyed in a will to the owner's heirs.

Fee simple absolute: A form of freehold ownership, not subject to termination.

Fee simple defeasible: A form of fee simple estate subject to termination if a condition is not being fulfilled or if there is an occurrence of a specified event; also called a qualified fee.

Fee simple subject to a condition subsequent: Form of estate ownership that can only be terminated by legal action in case a condition is not fulfilled; also called a conditional fee.

Fidelity bond: Bond that covers any losses that occur due to an employee's dishonesty.

Fiduciary relationship: Relationship of trust and loyalty in which one party owes a high level of good faith and loyalty to someone else. For example, an agent is in a fiduciary relationship with his principal.

Financial statement: Summation of facts that show the financial

condition of an individual (or a business), including a detailed list of assets and liabilities.

Finder's fee: A referral fee paid to someone who directs a buyer or a seller to a real estate agent.

First lien position: Mortgage or a deed of trust that has a higher lien priority than any other mortgage or deed of trust against the property.

Fiscal year: Twelve-month period that is used as a business year — in contrast to a calendar year—for accounting, tax, and other financial activities.

Fixed disbursement plan: Financing arrangement in a construction project where loan proceeds are to be disbursed in a series of preset installments at different phases of the construction.

Fixture: Personal property that is permanently attached to land or improvements so that it becomes a part of the real property.

Floor area ratio: Zoning requirement controlling the ratio between a building's floor space and the percentage of the lot occupied.

Foreclosure: Sale of real property by mortgagee, trustee, or other lien-holder when a borrower defaults.

Foreclosure, Judicial: (a) Sale of property as ordered by the court.

(b) Lawsuit that is filed by a mortgagee or deed of trust beneficiary to foreclose on the security property of a defaulting borrower.

Foreclosure, Nonjudicial: Trustee's foreclosure under the power of sale clause in a deed of trust.

Foreign Investment in Real Property Tax Act (FIRPTA): Federal law which requires a real estate seller to withhold funds from a buyer who is neither a U.S. citizen nor a resident alien.

Forfeiture: Failure to perform a duty or condition leading to a loss of

rights or something else of value.

Franchise: Government-granted right or privilege for conducting a particular business, or a private business-granted right for the use of its trade name for conducting a particular business.

Fraud: Premeditated or careless misrepresentation or cover-up of a material fact—on which someone is relying, causing him to suffer loss or harm.

Fraud, Actual: Premeditated deceit or misrepresentation to cheat or defraud someone.

Fraud, Constructive: Misrepresentation made without any fraudulent intent.

Freehold: Estate in land where ownership is for an indefinite length of time, such as a fee simple or a life estate.

Front foot: Property that is measured by the front linear foot on its street line, each front foot extending the depth of the lot.

Front money: Money needed to initiate a project, including expenses such as attorney's fee, loan charges, feasibility studies, and a down payment.

Frontage: Distance between the two side boundaries at the front of the lot.

Fructus industriales: Plants such as crops that are cultivated by people.

Fructus naturales: Plant growth that flourishes naturally, such as trees, plants, and shrubbery.

Fugitive substance: Substance that is not stationary in nature such as natural gas, oil, and water.

Functional obsolescence: Loss of value from causes within the property, excluding any due to physical deterioration.

Garnishment: Legal procedure through which a creditor acquires access to the funds or personal property of a debtor previously under the control of a third party.

General plan: Long-term, comprehensive plan for development of a community implemented through zoning and other laws; also called a comprehensive plan or master plan.

Gift funds: Money given by a relative (or a third party) of a buyer who himself does not have enough cash to close a transaction.

Good faith deposit: Deposit provided by a prospective buyer to the seller as evidence of his good intention of closing the transaction; also called an earnest money deposit.

Goodwill: Intangible asset of a business it acquires from having a good reputation with the public. Goodwill is generally an indication of the future return business.

Government National Mortgage Association (GNMA) (Ginnie Mae): One of the three main secondary market agencies, this federal agency is part of the Department of Housing and Urban Development.

Government-sponsored enterprise: GSEs are private corporations chartered and managed by the federal government. Secondary market agencies Fannie Mae and Freddie Mac are the most important GSEs in the real estate industry.

Government survey system: System of grids made up of range and township lines dividing land into townships, which are further subdivided into sections. Identification of a particular property is done through its location within a particular section, township, and range; also called the “rectangular survey system.”

Grant: To transfer or convey an interest in real property through a written instrument.

Grantee: Person receiving a grant of real property.

Granting clause: Words in a deed that point out the grantor's granting clause.

Grantor: Person conveying an interest in real property.

Gross income multiplier: Figure multiplied by the gross income of a rental property to calculate an estimate of the property's value; also called the gross rent multiplier.

Gross income multiplier method: Way of appraising residential property by reference to its rental value; also called gross rent multiplier method.

Guardian: Person appointed by a court to manage the affairs of a minor or an incompetent person.

Guide meridians: Lines running north-south (parallel to the principal meridian) at 24-mile intervals, in the Government Survey System.

Habendum clause: Clause included after the granting clause in many deeds; it begins, "to have and to hold" and describes the type of estate the grantee will hold.

Habitability, Implied warranty of: Warranty implied by law in every residential lease that states that the property is fit for habitation.

Heir: One who is entitled to inherit the property of another under the laws of intestate succession.

Heirs and assigns: Phrase used in legal documents to take into account all successors to a person's interest in property. Assigns are successors who acquire title in some manner other than inheritance (e.g., in deed).

Hereditament: Real or personal property that can be inherited.

Hereditament, Corporeal: Real or personal tangible property that can be inherited; a property with physical substance such as a car or a house.

Hereditament, Incorporeal: Real or personal property that is intangible and can be inherited; for example, an easement appurtenant or accounts receivable.

Highest and best use: Legal and physically possible use of a property that, at the time it is appraised, is most likely to generate the greatest return over a particular time period.

Holder in due course: One who has taken a note, check, or similar asset prior to it being overdue—in good faith and for value—and with no knowledge that it had previously been dishonored.

Holdover tenant: Tenant who keeps possession of leased property after the lease term has expired.

Home equity line of credit (HELOC): Credit account secured by equity in the borrower's home, enabling him to borrow up to a specified credit limit.

Home equity loan: Loan secured by a second mortgage on a principal residence, usually used for a non-housing purpose.

Homeowners association: Non-profit organization comprising homeowners from a particular subdivision, responsible for enforcing their CC&Rs and managing other community affairs.

Homestead: Dwelling occupied by the owner along with any appurtenant outbuildings and land.

Homestead law: State law providing limited protection to homestead properties against judgment creditor's claims.

HUD: See Department of Housing and Urban Development

Hypothecate: Using real property as collateral for a debt without having to give up possession of it.

Implied agency: Understood from actions or circumstances without expressing in words that an agency relationship exists.

Impounds: Borrower's funds collected and kept in a reserve account by the lender.

Improvements: Additions to land property that are man-made.

Imputed knowledge: Legal doctrine stating that a principal is considered to have notice of information that the agent has, even if the agent never told the principal.

Inadvertent dual agency: Occurs when a real estate agent—while representing one party to a transaction—unintentionally becomes the agent of the other party (i.e., a dual agent) by leading the other party to believe he is acting as his agent.

Inchoate: Unfinished or incomplete; a task begun but not completed.

Inchoate instruments: Documents not fully executed, or documents that should be, but have not been, recorded.

Income, Disposable: Income that remains after the payment of taxes.

Income, Effective gross: Measure of a rental property's capacity to generate income calculated by subtracting a bad debt/vacancy factor from the economic, rent-potential gross income.

Income, Gross: total income of a property before making any deductions such as bad debts, vacancies, operating expenses, etc.

Income, Net: Income that is capitalized to estimate the value of a property. It is calculated by subtracting the operating expenses (e.g., fixed expenses, maintenance expenses, and reserves for replacement) of the property from the effective gross income.

Income, Potential gross: Economic rent of the property; the income the property would earn if it were available for lease in the current market.

Income approach to value: One of the three main methods of appraisal in which an estimate of the property value is based on the net income it produces; also called the capitalization method or the

investor's method of appraisal.

Income property: Property which generates rent or other income for the owner, referred to as property held for the production of income in the income-tax code.

Income ratio: Criteria used for qualifying a buyer for a loan, to find if their income is sufficient. The buyer's debt and proposed housing expenses should not be over a specified percentage of his income.

Incompetent: Person who cannot manage their own affairs due to reason of insanity or lack of mental capacity; business matters relating to an incompetent should be overseen by a guardian.

Incorporeal rights: Rights in real property where physical possession is not involved, as in an easement.

Index: Changes in the cost of money indicated in a published statistical report, which can be used to make adjustments in such areas as wages, rental figures, and loan interest rates.

Inflation: Decrease in money's purchasing power, measured by the Consumer Price Index; real estate is considered a hedge against inflation because it generally holds its value.

Injunction: Court order or writ designed to stop a party with a lawsuit from committing an act that is seen as unjust or inequitable in regard to the rights of another party.

Installment sales contract: Real estate purchase structured to be paid in installments with title retained by seller until all payments are made; also called contract of sale and land contract.

Installments: Portion of a debt paid in successive periods, usually to reduce a mortgage.

Instrument: Written document formulated to set the rights and liabilities of the parties; examples are a will, lease, or promissory note.

Inter vivos trust: Trust created during a person's lifetime.

Interest: (a) Money charged by bank or other lending institution for the use of money. (b) A partial degree of ownership.

Interest rate: Percentage of an amount of money that is the cost of using it, usually expressed as a monthly or yearly percentage.

Interpleader: Proceeding started by a third party to find the rights of other claimants to a property or in a transaction.

Intestate: One who dies leaving no will, or a will that is incomplete or not transacted correctly; property then is conveyed to heirs at law or next of kin.

Investment property: Property acquired for its capacity to produce income or anticipated resale value, such as office buildings or undeveloped land.

Involuntary lien: Lien applied against a property without the owner's agreement, such as unpaid taxes.

Irrevocable: Incapable of being reversed or revoked; unalterable.

Joint tenancy: Ownership of a property interest by two or more parties, each of whom has an undivided interest with the right of survivorship (sharing equally in the interest of a deceased joint tenant with the surviving tenants).

Joint venture: Agreement to invest in a single property or business by two or more parties.

Judgment: A court ruling directing that one party is indebted to another, and setting the amount of indebtedness.

Judgment creditor: Party who has received a judgment from the court for money owed to her.

Judgment debtor: Party whom a judgment has been directed against for money owed.

Judgment lien: Claim upon the property of a debtor as the result of a

judgment, enabling the judgment creditor to have the property sold for payment to satisfy the judgment.

Junior mortgage: Mortgagee whose claims on a property will be addressed only after previous mortgages have been settled.

Laches: Negligence or delay in putting forward one's rights.

Land: Earth's surface area that is solid and not composed of water.

Land contract: Installment agreement for the purchase of real estate in which the buyer may use and occupy the land, without the passage of deed or title until all or a portion of the selling price is conveyed.

Landlord: Person, the lessor, who rents property to another person, the lessee.

Landmark: A stationary object that serves as a boundary or reference point for a land parcel.

Late charge: Amount assessed by a lender against a borrower who misses making an installment payment when due.

Lateral support: Support which the ground of an adjoining property provides to a neighbor's land.

Lease: Contract agreement in which an owner of real property, in exchange for the consideration of rent, passes the rights of possession to the property to another party for a specified time period.

Leasehold estate: Tenant's ownership interest in the property that is leased to her.

Leasehold improvements: Fixtures attached to real estate that are installed by the tenant and which can be moved by him after the lease's expiration if their removal does not damage the property.

Legal description: Legally proper identification of realty by one of three agreed-upon methods: the government rectangular survey, metes and bounds, lot and block number.

Lessee: Person to whom property is rented under a lease; a tenant.

Lessor: Person who rents property to another person; a landlord.

Leverage: Using borrowed funds to raise purchasing power and enhance profitability of an investment.

License: Having the right granted by the state of California to work as a real estate broker or salesperson.

Licensee: Person who hold a real estate license, which conveys the privilege to accept compensation for helping with a real estate transaction.

Lien: Encumbrance against property rendering it security for the payment of a debt, mortgage, or other money judgment.

Life estate: Freehold land interest that terminates upon the death of the owner or another designated person.

Life tenant: Individual who is permitted to possess property for her lifetime or during the lifetime of another specified person.

Limited partnership: Business organization in which at least one partner is passive, with liability limited to the sum invested, and one partner whose liability extends beyond his amount invested.

Liquidated damages: Amount designated in a contract that one party will owe the other party in case of a breach of contract.

Lis pendens: Recorded notice that the rights to the possession of real property is the subject of litigation, thus affecting disposition of its title.

Listing: (a) Employment contract in writing between an agent and principal, authorizing the agent to conduct services for the principal regarding the principal's property. (b) A record of the property for sale by the broker authorized by the owner to sell it.

Loan-to-value ratio (LTV): Ratio calculated by dividing the mortgage principal by the property value.

Lock-in: Agreement to maintain a certain rate or price for a specified time period.

Lot and block number: Method of land description that relies on the placement of recorded plats.

MAI: Professional membership in the Appraisal Institute.

Margin: Figure added to an index in order to adjust an interest rate on an adjustable-rate mortgage.

Marginal property: Realty that generates barely enough income to cover the cost of using it

Marketable title: See insurable title. Title that a court will assess as being free enough from defect so it will enforce its acceptance by buyer.

Market data approach: One of the three methods of appraisal, it compares recently-sold properties to the property being appraised. See Sales comparison approach

Market price: Actual price paid for a property in a transaction.

Market value: Highest price a willing buyer will pay for a property and the lowest a willing seller will accept—assuming no undue, outside pressures.

Material fact: Fact that is significant in regard to a particular transaction, without which it can be assumed a contract would not be agreed upon.

Mechanics lien: Lien created by law against real property as security for payment for the labor and materials used for the improvement of the property.

Mello-Roos Community Facilities Act: Enacted in 1982, it authorizes creating community facilities, issuing bonds, and levying taxes to finance specified public services.

Meridian: North-south line used in government rectangular survey.

Metes and bounds: Land description method that relies on land boundary lines, utilizing those lines with their terminal points and angles.

Mineral rights: Authorization to amass income from the sale of gas, oil, and other resources underground.

Misrepresentation: Untrue or misleading statement, whether unintentional or on purpose. Where there's a misrepresentation of a material fact, the injured individual may sue for damages or revoke any agreement affected by the false assertion.

Monument: Fixed object and point specified by surveyors to establish land locations, such as boulders or unusual trees.

Mortgage: Written instrument that establishes a lien on real estate as security for payment of a designated debt.

Mortgage banker: Person who originates, finances, sells, closes, and services mortgage loans, which are generally insured or guaranteed by a private mortgage insurer or government agency.

Mortgage broker: Places loans with investors for a fee, but does not service them.

Mortgage commitment: Agreement between a borrower and a lender to set up a loan at a later date, dependent on the conditions specified in the agreement.

Mortgage loan disclosure statement: Statement on a form approved by the Real Estate Commissioner that discloses to a potential borrower the terms and conditions of a mortgage loan - required by law to be proffered by mortgage brokers before the borrower is bound by the loan terms.

Mortgagee: Someone who receives a mortgage from a mortgagor to secure a loan or performance of a duty; also called a lender or creditor.

Mortgagor: Person who provides a mortgage on property to a mortgagee to secure a loan or the mortgagee's performance of a duty.

Multiple listing: Arrangement between real estate brokers to cooperate by providing information to each other regarding listings and to split commissions between the listing and selling brokers.

National Association of Realtors (NAR): Organization which promotes professionalism in real estate business.

Negative amortization: Increase in a loan's outstanding balance due to periodic debt-service payments not covering the total amount of interest attached to the loan.

Net income: Actual earnings remaining after deducting all expenses from gross income.

Net lease: In addition to rent, tenant pays charges against the property, such as taxes, insurance, and maintenance.

Net listing: In a sale, broker's commission payment is anything over and above an agreed-upon net price to the seller.

Net operating income: The income from realty or a business after deducting operating expenses but before deducting tax payments on and interest and principal payments.

Non-conforming loan: Mortgage loan that does not meet the criteria for being funded by Fannie Mae or Freddie Mac.

Note: Written instrument acknowledging a debt and promises to pay.

Notice, Actual: Implied or express factual knowledge.

Notice, Constructive: Fact which should have been discovered due to one's actual notice and/or inquiries that a reasonably prudent person would be expected to make.

Notice, Legal: Notice required by law to be given.

Notice to quit: Notice provided to a tenant to vacate property.

Novation: Substitution of a revised agreement for a previous one, and agreed to by all parties.

Null and void: Without any legal validity.

Obsolescence: Decline in value due to a reduction in desirability and usefulness of a structure—because its design and construction become obsolete or decline due to the structure becoming outmoded (i.e., not in keeping with current needs).

Offer to purchase: Proposal to a property owner by a potential purchaser to acquire the property under previously-stated terms.

Open listing: Listing provided to a number of brokers without a duty to compensate any besides the particular broker who first secures a buyer—ready, willing, and able to accept the listing's terms—or obtains the seller's acceptance of a different offer.

Open mortgage: Mortgage that has matured or whose payments are late, so that it is open to being foreclosed upon.

Open-end mortgage: Mortgage including a clause under which the mortgagor may obtain additional funds from the mortgagee after a certain number of loan payments have been made.

Operating expenses: Funds used to maintain property, such as insurance and repairs, but excluding depreciation or finance costs.

Operating lease: Lease that a lessee subleases to another party who is the actual user of the property.

Option: Right, without the obligation, to lease or purchase a property upon specified terms during a specified period.

Optionee: One who receives or acquires an option.

Optionor: One who gives or sells an option.

Oral contract: An agreement not in writing, usually unenforceable.

Ostensible authority: Authority that a reasonable third person believes an agent was given, due to the principal's acts or omissions.

Overall capitalization rate: Rate calculated by dividing net operating

income by the property's purchase cost.

Package mortgage: Mortgage created in which the principal loan amount is raised to include improvements and movable items such as appliances, along with real estate.

Paramount title: Title which takes priority over any others.

Partition: Dividing real property between its owners in undivided shares.

Partnership: Agreement between two or more parties to enter into a business venture with each partner sharing in the partnership's profits, as well as being liable for its debts.

Party wall: Constructed on the dividing line between two properties with different ownership, a wall that either party has a right to use.

Patent: Title conveyed to government land.

Percentage lease: Property lease with the rental amount based on a percentage of sales made on the premises, with a set minimum amount; usually used by retailers.

Periodic estate: Lease based on a specified calendar amount of days, like month to month or year to year; also called a periodic tenancy.

Personal property: All property that is not realty; also known as personality.

Physical depreciation: Decline in value stemming from age, wear and tear, and the elements.

Planned unit development (PUD): Zoning or land-use plan for large tracts that includes intensive development of common and private areas, designed as one integrated unit.

Plottage: Increasing the value of a plot of land that has been assembled from smaller plots under a single ownership.

Points: Fees provided to lenders to attract a mortgage loan. One point

equals one percent of the principal loan amount, which lowers the funding amount advanced by the lender, effectively raising the interest rate.

Police power: Government right to pass laws and enforce them to achieve health, order, public safety, and general welfare for the public.

Power of attorney: Instrument through which a principal confers authority to a person to act as her agent.

Premises: Land and buildings; an estate.

Prepayment clause: Mortgage clause conveying the privilege to a borrower to pay her entire debt prior to its maturity; in some cases, a penalty is assessed against the borrower for exercising this right.

Principal: (a) Employer of a broker or agent. (b) Amount of money from the mortgage or other loan, apart from the interest due on it. (c) One of the main parties in a real estate deal.

Private mortgage insurance (PMI): Mortgage guarantee insurance that protects conventional lenders in case of default, with premiums paid by the borrower.

Probate: To prove the validity of a will of a deceased person.

Procuring cause: Legal term for the cause resulting in the objective of a real estate broker or agent procuring a ready, willing, and able realty purchaser—used to determine who is entitled to a commission.

Promissory note: Borrower's signed promise to repay the loan to a specific person under specific terms.

Property: Rights that a party has to use and possess land or chattel to the exclusion of anyone else.

Proprietorship: Business ownership, including the management of real estate, by a person, as opposed to a corporation or partnership.

Proration: Allocation between seller and purchaser of proportional

shares of a debt that has been paid—or due to be paid—regarding a realty sale, such as property taxes and insurance.

Purchase capital: Funds used to purchase realty, from whatever source.

Purchase money mortgage: Mortgage provided by a buyer (grantee) to a seller (grantor) in partial payment of a real estate purchase price.

Quiet enjoyment: Right of an owner or tenant to the use of a property without any interference to their possession.

Quiet title: Court action to remove a defect or cloud on an owner's legal right to a piece of realty.

Quitclaim deed: Conveyance establishing only the grantor's interest in real estate, with no ownership warranties.

Range lines: Used in the government rectangular survey method of land description; they are lines parallel to the principal meridian, demarcating the land into 6-mile strips called ranges.

Ratification: Approval of an action done on someone's behalf without prior authorization.

Real estate: Land and all permanent attachments to it.

Real Estate Advisory Commission: Ten-member board that makes recommendations to the Real Estate Commissioner on pertinent issues.

Real Estate Commissioner: Governor-appointed head of the Bureau of Real Estate (BRE), who appoints the Real Estate Advisory Commission and administers the Real Estate Law.

Real estate investment trust (REIT): Mutual fund authorized by law to be immune from corporate taxes if most of its profits are distributed to individual investors who are taxed.

Real property: All the rights in ownership to use real estate.

Realtor: Real estate professional following the code of ethics based on their membership in the National Association of Realtors.

Recapture clause: Contract clause allowing party granting an interest or right in real estate to re-take it under specific conditions.

Recording: Act of entering documents regarding title to real estate in the public record.

Recourse: Authority of a lender to assert a claim to funds from a borrower in default, besides the property pledged as collateral.

Redlining: Unlawful policy by a lender of not making loans in certain areas with high minority populations due to alleged overall lending risks, without considering creditworthiness of each applicant.

Release clause: Mortgage clause that provides property owner with the right to pay off part of their indebtedness, releasing a specified portion of the property from the mortgage.

Reliction: Gradual lowering of water level, uncovering dry land.

Remainder: Estate that goes into effect after a prior estate, usually a life estate, is terminated.

Rent: Compensation paid for the use of realty.

Replacement cost: In appraisals, the cost of construction to replace or serve the same function as a similar, previous building.

Reproduction cost: In appraisals, the cost of construction of a replica of a property as of a certain date.

Rescission: Terminating a contract and restoring the parties to the identical positions they occupied before entering into the contract—permitted when the contract was induced by fraud, duress, misrepresentation, or mistake.

Restriction: Limitation placed on property use, as included in the deed or other instrument in the chain of title.

Reversion: Lessor's right to take possession of leased property upon the end of a lease.

Reversionary interest: Future interest held by a person in property upon the termination of the preceding estate.

Revocation: Recalling power of authority previously conveyed, such as by an agency.

Right of survivorship: Right of a surviving joint tenant to take the interest of a deceased joint owner.

Right of way: Easement, right-to-use access or passage to a specific path, as well as the subdivision areas allocated to government use (e.g., streets and other types of public access).

Riparian rights: Rights regarding water use on, under, or adjacent to a person's land—providing reasonable use of such water.

Rumford Act: See Fair Employment and Housing Act

Sale-and-leaseback: Seller retains occupancy to land by leasing it back simultaneously with its sale, generally for a long term lease.

Sales comparison approach: In appraisals, estimating value through analysis of comparable properties' recent sales prices.

Salesperson: One licensed to perform any act authorized by the state's Real Estate Law, if employed by a broker who is also licensed.

Sandwich lease: Leasehold which has been sublet by a lessee to another party, so the former becomes a lessor.

Section of land: Square mile in the government rectangular survey description of land.

Security instrument: Realty interest permitting the property to be sold if the obligation for which the security interest was created is defaulted upon.

Separate property: As distinguished from community property, property owned by a spouse prior to marriage—acquired by gift or bequest, or by proceeds from other separate property.

Setback: Area from the curb or other set line of demarcation within which no structures can exist.

Special assessment: Property is assessed a certain amount to pay for public improvements which will benefit the property.

Special warranty deed: Deed under which the grantor warrants the title provided to the grantee only against defects that arose during grantor's ownership, not from any that might stem from conditions existing before that time.

Specific performance: Court action directing a party to fulfill contract terms which he has refused to perform.

Statute of Frauds: State law holding that certain contracts be in writing and signed to be enforceable, unless the terms of a contract can be performed within one year.

Straight-line depreciation: Method of depreciation which uses equal yearly reductions to estimate property's book value.

Subagent: One who receives the powers of an agent not from a principal, but from another agent whom the principal has authorized to do so.

Subdivided Lands Law: Regulating the sale of subdivided land in California, this law mandates a subdivision meet state standards and that the Real Estate Commissioner publish a Subdivisions Public Report provided to potential purchasers.

Subdivision: Land tract divided into plots, appropriate for the construction of homes, under the state's Subdivided Lands Law.

Subject to mortgage: Method to take title to mortgaged realty without being personally liable for payment of amount due on the promissory note. If the new buyer fails to make payments going forward, the most he will lose is his equity in the property.

Sublease: Lease from a lessee to a different lessee, who becomes the sublessee or subtenant.

Subordination clause: Instrument allowing a mortgage recorded at a subsequent date to take precedence over an earlier mortgage.

Surety: One who guarantees another's performance; a guarantor.

Surrender: Lease's cancellation before its termination by consent of both the lessor and lessee.

Survey: Procedure under which a parcel of land is measured and its area calculated.

Tax: Charge assessed against individuals, corporations, and organizations to fund government.

Tax-free exchange: Trade of one property for another that is excluded from tax liability on any profit when the trade occurs.

Tax sale: Property being sold after a period of unpaid taxes.

Tenancy at sufferance: Tenancy created when a lawful tenant retains possession of a property after the lease terminates.

Tenancy at will: License to possess realty and tenements for an indefinite period, at the owner's will.

Tenancy by the entirety: Estate that exists just between spouses, with each having equal right of possession and with right of survivorship.

Tenancy in common: Ownership of real property by two or more persons, with each having an undivided interest but without the right of survivorship.

Tenant: Person given possession of real property belonging to someone else for a fixed term or at will.

Testament: A will.

Testamentary trust: Trust established by will, which only comes into effect after testator dies.

Testate: The making of a valid will.

Time is of the essence: A contract condition requiring that all references to specified dates regarding performance be followed exactly.

Title: Establishes that a land owner has lawful possession of a property, having all the elements of ownership.

Title insurance: Insurance policy providing protection from losses caused by possible defects in the title.

Title search: Public records inquiry to ascertain any issues of ownership and encumbrance regarding realty.

Topography: Surface of the land; may be hilly, flat, rocky.

Tort: Wrongful act, not criminal in nature, but giving rise to a civil action with the one committing the tort (tort-feasor) potentially liable for civil damages.

Township: Six-mile square tract located between two range lines and two township lines, created by government rectangular survey.

Trade fixtures: Articles annexed to rental structures by a commercial tenant in the course of operating their business, removable by the tenant.

Trust deed: Conveyance of realty to a neutral third party (trustee) which that person holds for another party's benefit.

Trustor: Party who gives property to a trustee to be held on a beneficiary's behalf, so that the trustor becomes the owner of real estate and the lender is the beneficiary.

Unearned increment: A rise in real estate value due to no effort by the owner, usually due to population growth.

Unit in place method: Projecting the cost of building a structure based on estimating the price of its individual components, such as the foundation, floors, walls, and cost of labor.

Unity: Four unities are needed to establish a joint tenancy: interest, possession, time, and title. Thus, joint tenants are required to have equal interests created by a conveyance, the identical undivided possession, and the same use during the same time.

Unruh Act: State law requiring borrowers be provided with explicit notices of default on mortgages, to safeguard homeowners from losing their residence due to default on an installment purchase.

Usury: Interest rate impermissibly set higher than allowed by law.

Utility: One of the elements of value—the capability to provide gratification—inciting the wish to possess a property.

Valid: Having legally sufficient force, enforceable by a court.

Value: What something is worth to a particular party.

Variable expenses: Operating costs for a property that rise upon occupancy.

Vendee: Buyer; a purchaser.

Vendee's lien: Lien applied to property according to a contract of sale, to secure buyer's deposit.

Vendor: Seller.

Void: With no force of law or effect

Voidable: Something that can be voided, but action must be directed to void it.

Voluntary alienation: Term designating a sale or gift made with free will.

Warranty: Promise or guaranty included in a contract.

Warranty deed: Instrument that includes a covenant declaring the grantor will protect the grantee from claims on title.

Will: Directions for the disposition of one's property after death.

Without recourse: Phrase employed in endorsement of a note or bill indicating that the holder cannot expect payment from the debtor personally if non-payment occurs.

Zoning: Governmental authority designating an area for a particular use.

INDEX

A

acceleration clause, 326
adjustable rate mortgage, 339, 343, 398
agency relationships, 40, 41, 46, 69
alienation clause, 326
All Inclusive Trust Deed, 330
amendments, 357, 366
anchor tenants, 403
Anti-Discrimination Laws, 270
appreciation, 50, 153, 154, 155
Appropriative rights, 423, 424
Assignment, 425
automated underwriting, 302, 319

B

balloon payoff, 327
Bankruptcy
 Chapter 11, 426
beneficial interests, 183, 205, 368
bilateral agreement, 191
blanket loan, 333
Blockbusting, 428
boot, 428
broker preview, 185

C

California Association of REALTORS, 265
CalVet loans, 298
capitalization rate
 safe rate, 465
chain of title, 183, 205, 369, 371, 376, 469
Chapter 7 bankruptcy, 130, 131
chattel, 467
cold calls, 205
commercial banks, 292, 295, 306, 355, 450, 451
commingling, 46, 406
commission, 5, 9, 10, 22, 23, 24, 25, 42, 44, 48, 49, 50, 64, 68, 69, 71, 76, 106, 109, 121, 136, 162, 185, 191, 192, 193, 194, 195, 196, 197, 206, 208, 209, 212, 213, 214, 237, 253, 268, 269, 324, 365, 374, 379, 385, 406, 407, 409, 429, 435, 449, 464, 467
Comparative Market Analysis, 100, 115, 182, 224
competitive market analysis, 92
Condemnation, 436

consideration, 190, 191, 207, 325, 421, 437, 438, 439, 442, 460
contractual obligation, 429
conversion, 46, 416
cooperating agents, 213
credit history, 300, 303, 307, 310, 311, 317, 319
credit report, 60, 207, 300, 302, 310, 311, 312, 315, 316, 317, 318, 320, 344, 435
credit unions, 55, 284, 289, 292, 309
Crowdfunding Platforms, 294

D

debt service coverage ratio, 341, 343
debt-to-income ratio, 51, 172, 174, 296, 302, 319, 332, 341, 343
Dedication, 442
Documentary Transfer Tax, 365, 378
Dodd-Frank Act, 26, 55
dual agency, 42, 69, 260, 457

E

Eminent domain, 447
endless chain, 115, 116, 135
environmental hazards, 228
equitable interests, 330
escrow, 35, 42, 45, 48, 49, 50, 54, 62, 68, 76, 85, 86, 94, 109, 114, 126, 147, 150, 153, 157, 180, 181, 185, 188, 192, 194, 205, 212, 219, 229, 238, 253, 255, 262, 263, 265, 266, 267, 268, 269, 273, 325, 329, 347, 348, 349, 350, 351, 352, 354, 356, 357, 358, 360, 361, 362, 363, 365, 366, 367, 369, 373, 375, 376, 377, 378, 379, 385, 418, 448
escrow agent, 348, 350, 352, 356, 357, 358, 360, 361, 362, 363, 366, 373, 375, 378, 448
escrow companies, 351, 369, 376
estate for years, 391
Exclusive Authorization and Right to Sell, 194, 195, 206, 208
executor, 419, 437
expired listings, 177, 205
extended coverage policy, 370, 376, 379
exterior improvements, 199

F

Fair Credit Reporting Act, 313, 316, 317
Fannie Mae, 286, 288, 301, 302, 306, 332, 437, 451, 454, 464

farming, 109, 136, 205
FICO score, 295, 310, 318, 334, 342, 344
fiduciary, 45, 69, 71, 350, 351, 375, 421, 451
finder, 43
fixture, 423
floor time, 243, 246, 271, 273
foreclosure, 14, 30, 32, 33, 34, 52, 62, 63, 98, 123, 124,
126, 129, 131, 135, 138, 156, 176, 180, 221, 224, 226,
288, 295, 297, 326, 327, 330, 331, 332, 338, 372, 398,
399, 400, 433, 441, 443, 447, 452
Foreign Investment in Real Property Tax Act (FIRPTA), 375, 452
fraud, 428, 439, 469
Freddie Mac, 288, 301, 302, 306, 337, 437, 450, 454,
464
FSBO, 121, 122, 123, 135, 137, 177

G

geographic farm, 105, 107, 110, 111, 134, 135, 136
Ginnie Mae, 289, 306, 444, 454
Good Faith Deposits, 265

I

implied warranty of habitability, 394, 397
independent contractor, 41, 42, 69
independent escrow, 348, 349, 351, 369, 375, 376, 377
inflation, 28, 30, 50, 145, 154, 279, 280, 282, 284, 305,
384, 387, 392, 458
installment sales contracts, 326
intestate, 444, 455

J

junior trust deed, 338
just compensation, 436, 447

L

land contracts, 298, 371
lead-based paint disclosure, 231, 241
lease termination, 389, 395
leasehold interests, 376, 388, 396, 414
lessee, 42, 191, 388, 396, 413, 414, 460, 465, 470, 471,
472
lessor, 42, 191, 388, 396, 413, 414, 460, 470, 472
leverage, 152, 387
life insurance companies, 306
listing contract, 189, 192, 194, 210
listing extensions, 221

listing price, 94, 114, 143, 179, 184, 188, 190, 192, 212,
215, 217, 219, 223
loan origination fee, 291, 298
lockboxes, 204

M

margin, 26, 27, 121, 188, 335, 339, 340, 343
master plan, 454
Mello-Roos, 462
MLS, 94, 101, 103, 112, 113, 121, 122, 180, 184, 185, 191,
193, 198, 203, 205, 212, 213, 217, 219, 239, 240, 250,
261
modifications, 57, 210, 370
mold, 201, 232, 234, 235, 238, 241, 411
Mortgage, 428, 439, 450, 451, 452, 454, 463, 464, 465,
466, 467, 468, 469
Mortgage Loan Originator, 70, 290
mortgage loan servicing, 223, 237, 291

N

National Association of Realtors, 5, 6, 37, 106, 122,
137, 173, 406, 441, 464, 468
National Do Not Call Registry, 119, 135
Natural Hazard Disclosure Statement, 230
negative amortization, 26, 31, 335
net listing, 196, 197
net sheet, 188, 189, 206, 207, 224, 347, 349, 358, 359,
360, 361, 362, 364, 376, 378

O

Offer
offeror, 465
One Click Rule, 161, 172
open houses, 168, 237, 243, 244, 245, 271, 272
open listing, 195, 208
open market operations, 282, 306, 308

P

periodic tenancy, 389, 391, 396, 413, 466
potential gross income, 426, 457
primary mortgage market, 284, 306
Principle of Progression, 95, 101, 103
Principle of Regression, 95, 101, 103
Principle of Substitution, 184, 205
private mortgage insurance, 337
procuring cause, 50, 193, 194, 195, 269
promissory note, 458, 471
prospecting, 74, 81, 105, 115, 136

Q

qualified mortgage, 85

R

Ratification, 468

Real Estate Settlement Procedures Act, 373, 376

Recording, 469

redlining, 270

Regulation, 169, 175, 352

REITs, 293

right to use, 430, 439, 446, 466

Riparian rights, 470

Rumford Act, 270, 430, 450, 470

S

SAFE Act, 53, 54, 55, 61, 70, 72, 289

safety clause, 269

savings banks, 284, 286, 306, 309, 324

secondary financing, 285, 333, 338

secondary income sources, 304

selling agent, 42, 68, 155, 439

signed contract, 194, 210, 237, 269, 389

spam, 76, 165, 166, 170, 172, 175

staging, 203, 204, 215, 237

T

Termination Date, 193

Terms of Sale, 192

The 3C's, 300, 307

The California Housing Finance Agency, 299

The Credit Crisis, 3, 31

three-day notice to pay or quit, 400, 414

Timing & Delivery, 228

title companies, 369

tort, 441, 473

Township, 473

Transfer Disclosure Statement, 225, 238, 240

Trust company, 355

U

Unenforceable, 438

unilateral contract, 196, 206

unlawful detainer, 400, 401, 414

Unruh Act, 270, 474

V

voidable, 445

W

walk through, 67, 184, 204, 228, 245

Warranty, 455, 474

wraparound mortgage, 169, 326, 327, 330

writ of possession, 401, 414