

Florida Salesperson PLE

UNIT I: Brokerage Management

Module 1

The Economics of Real Estate Management

ESCROW ACCOUNTS AND PHYSICAL & ECONOMIC CHARACTERISTICS OF REAL ESTATE

Learning Objectives

- Explain the meaning of “immediately” and related deposit timing requirements for earnest money deposits.
- Describe the four settlement procedures available when escrow funds are disputed.
- Understand a broker’s rights and limitations regarding commissions and escrow funds.
- Identify prohibited escrow practices such as commingling and conversion.
- Understand the physical and economic characteristics of real estate.
- Identify factors that influence real estate supply and demand.
- Distinguish among buyer’s markets, seller’s markets, and other market conditions.
- Interpret common real estate market indicators such as housing starts, vacancy rates, and foreclosure activity.

- Recognize the importance of local market trends when serving clients.

Escrow (Trust) Accounts

An escrow account is the method of holding money or documents on behalf of another until specified terms and conditions have been satisfied. A broker is only required to have an escrow account if he holds money or property for other people. “Money” may be in the form of cash, or currency, any medium of exchange, or any securities to be converted into money, delivered for real estate or mortgage purposes.

Establishing Escrow Accounts (FAC 61J2-14.008; FAC 61J2-14.010)

An escrow account must be opened in a bank or trust company, title company having trust powers, credit union, or a savings and loan association within the state of Florida. The broker must be a signatory on all escrow accounts. If the brokerage firm has more than one broker licensee, then one broker licensee may be designated as the signatory.

Timing of Deposits—3 Business Days (FAC 61J2-14.008)

Every broker who receives items requiring deposit into escrow must deposit them by the end of the third business day following receipt of the item to be deposited. Receipt by a sales associate or any other representative of the brokerage firm constitutes receipt by the broker. Saturdays, Sundays, and legal holidays are not considered business days.

Sales Associate Duties (FAC 61J2-14.009)

Sales associates are not allowed to have escrow accounts. If the sales associate receives an item for deposit, he must deliver it to his employing broker by the end of the next business day following receipt. Receipt by a sales associate or any other representative of the brokerage firm constitutes receipt by the broker.

Timing/Deposit Verification When Placed with Title Company or Attorney (FAC 61J2-14.008)

When a deposit is placed (or will be placed) with a title company or an attorney, the licensee who prepared or presented the sales contract must indicate on that contract the name, address, and phone number of the title company or attorney.

Within ten (10) business days after each deposit is due under the sales contract, the licensee's broker must make written request to the title company/attorney to provide written verification of their receipt of the deposit, unless the deposit is held by a title company/attorney that was nominated in writing by a seller.

Within ten (10) business days after placing this request, the licensee's broker must provide the seller's broker with a copy of that written verification or a written notice that the verification was never received. If the seller is not represented by a broker, the licensee's broker must instead notify the seller directly.

Interest Bearing Escrow Accounts (FAC 61J2-14.014)

The broker may, but is NOT required to, place escrow funds in an interest-bearing account. If the broker does this, she must have the written permission of the parties, and must designate who will receive the interest and when it must be disbursed. The escrow account must be an insured account in a depository located and doing business in Florida.

Note that the broker has two options for disbursing the principal and interest.

1. ***The first option*** is for the broker to transfer the principal and interest to a non-interest bearing escrow account before it is disbursed.
2. ***The second option*** only applies if the funds were placed into an individual escrow account (created for that specific transaction or sum of money). In such case, the broker may close the individual account by withdrawing all of the proceeds for disbursement to the appropriate person(s).

A broker may disburse escrow funds as follows:

a. ***To the Depositor (Limited Right)***. A depositor has the right to demand return of a deposit until such time as another person has a claim on the deposit (for example, when the seller accepts the contract, he arguably has a right to the deposit). This right of the depositor arises again:

- (i) upon a breach of contract by the other party; or
- (ii) when the other party has not performed within a specified or reasonable time frame, as would be necessary to establish his own claim to said deposit.

b. *Upon the Consummation of the Transaction.* A broker may deliver the deposit to the appropriate party when the transaction is closed.

c. *Upon Written Agreement of the Parties.* The interested parties involved (other than the broker) may by express agreement order the disposal of the deposit, but the burden is on the broker to establish good faith in the matter if such agreement is to the broker's advantage. In such case, the broker must comply with the joint directions of the parties.

d. *Disbursing When There Are Conflicting Demands* (FS 475.25(1)(d)). The broker must provide written notice to the Commission if:

- (i) he has received conflicting demands from the parties; or
- (ii) has good faith doubt as to which person is entitled to the funds.

This notice must be provided to the Commission within 15 business days of the last party's demand or good faith doubt about the disbursement. Sales associates must inform their brokers immediately of any conflicting demands.

The broker must institute specified settlement procedures (known as "escape procedures") within 30 business days of the last party's demand or good faith doubt about the disbursement.

These "escape" procedures are also required when the parties act in bad faith to deprive the broker of his commission. In such case, a broker must institute one of the following:

- Request that the Commission issue an escrow disbursement order (EDO) determining who is entitled to the escrowed property.
- With the consent of all parties, submit the matter to arbitration.
- By interpleader or otherwise, seek adjudication of the matter by a court.
- With the written consent of all parties, submit the matter to mediation. The mediation may be conducted by DBPR or another entity, but must be successfully completed within 90 days following the last demand. Otherwise, the licensee shall promptly employ one of the other escape procedures.

10 Day Notice. If the broker has requested an EDO and the dispute is subsequently settled (or goes to court before the EDO is issued), the broker must notify the Commission within 10 business days of such event.

30 Day Notice. If the broker institutes a settlement procedure other than a request for an EDO, he must notify the Commission in writing about which procedure is being used to settle the dispute. The broker must provide such notice within 30 business days of the last party's demand or good faith doubt about the disbursement.

If the broker has requested an EDO and the Commission notifies him in writing that it will not be issued, the broker must then institute another settlement procedure. The broker must notify the Commission on which procedure he will initiate within 30 business days after receipt of the Commission's statement that they will not issue the EDO.

EXAMPLE: Good Faith Doubt

A real estate transaction does not go all the way through settlement and the broker contacts both parties to the transaction regarding disbursement procedures but does not hear back from one party. In this instance, the broker would have no choice but to notify that party the funds will be released to the other party if no response is received.

EXAMPLE: Good Faith Doubt

Upon closing, a broker receives disbursement instructions from one party to the transaction that do not match what was detailed in the sales contract.

Rights of Broker in Escrow Deposits (FAC 61J2-14.011)

A broker who receives a deposit has no right to or lien upon the deposit until the transaction has been closed (unless the depositor agrees otherwise). No person has any claim to the deposit except the party that is ultimately to receive the funds (usually the seller at the closing).

In such case, the broker may then deduct his agreed upon commission unless there is a dispute as to the amount or time of payment. If true, the broker must retain the disputed amount in escrow until the dispute is settled by agreement, arbitration, mediation, or court proceedings.

If the transaction does not make it to closing, refer to the previous section on the limited rights of the depositor. In such case, if the depositor (usually the buyer) had expressly agreed to pay a broker for time and expenses incurred, the broker may deduct such commission before returning the rest of the balance to the depositor.

Broker Must Review, Sign and Date Monthly Reconciliation Statement

Monthly Report. Once monthly, a broker must make a written reconciliation containing specific information required by the Commission. The broker must review, sign, and date the monthly statement-reconciliation.

Explanation of Discrepancies. Whenever the broker's trust liability and the bank balances do not agree, the reconciliation must contain an explanation for the difference(s) and any corrective action taken in reference to shortages or overages of funds in the account(s).

30 Day Rule. The broker has a "reasonable" amount of time to correct escrow errors if there is no shortage of funds and such errors pose no significant threat to economically harm the public. In this context, a reasonable amount of time is defined as 30 days from the date the last reconciliation was performed or should have been performed.

Misappropriation of Escrow Funds

No Commingling. Commingling is the act of mixing entrusted client or customer funds with personal or business funds.

Funds can only be placed in an escrow or trust account if the regulations require that they be deposited into escrow. This means that the personal funds of a licensee may NOT be deposited or intermingled with any funds held in escrow or trust, except in limited circumstances.

Under this exception, a broker may place and maintain up to \$1,000 of personal or brokerage funds in each sales escrow account, and may place and maintain up to \$5,000 of personal or brokerage funds in each property management escrow account (FAC 61J2-14.010).

No Conversion. Conversion is the act of stealing, using, or misappropriating entrusted client or customer funds. Conversion of escrow funds is prohibited.

Record Keeping and Retention

A broker who receives an escrow deposit must make available to the DBPR all deposit slips and bank statements, together with all agreements between the parties to the transaction.

In addition, the broker must keep accurate records of each deposit transaction. All such books and accounts are subject to inspection by the DBPR at reasonable times during regular business hours.

Title Company and Escrow Accounts (FAC 626.8473)

A title insurance agent may engage in business as an escrow agent as to funds received from others to be subsequently disbursed by the title insurance agent in connection with real estate closing transactions involving the issuance of title insurance binders, commitments, policies of title insurance, or guarantees of title. All funds received by a title insurance agent must be trust funds received in a fiduciary capacity by the title insurance agent.

All funds received by a title insurance agent to be held in trust shall be immediately placed in a financial institution that is located within the state of Florida and is a member of the Federal Deposit Insurance Corporation or the National Credit Union Share Insurance Fund.

The title insurance agents must maintain separate records of all receipts and disbursements of escrow, settlement, or closing funds.

Funds required to be maintained in escrow trust accounts by title companies will not be subject to any debts. The escrow money cannot be taken by:

- the title company's creditors
- lawsuits against the company
- business debts (rent, payroll, etc.)

The escrow funds must only be used in accordance with the terms of the individual, escrow, settlement, or closing instructions under which the funds were accepted.

A title insurance agent, or employee of the agent, who converts or misappropriates funds received or held in escrow or in trust by the title insurance agent commits one of the following:

If the funds converted or misappropriated are:

- (a) \$300 or less, a first degree misdemeanor

- (b) More than \$300 but less than \$20,000, a third degree felony
- (c) More than \$20,000 but less than \$100,000, second degree felony
- (d) \$100,000 or more, a first degree felony

Physical and Economic Characteristics of Real Estate

Physical Characteristics of Real Estate

Land includes the surface of the earth and the space above and below it. Owners may sell or transfer surface, air, and subsurface rights. All land has the following three physical characteristics that influence value: immobility, indestructibility, and uniqueness.

a. Immobility. Describes how property cannot be moved from one geographical location to another. Due to this characteristic, the value of real property is directly affected by its external surroundings. However, natural forces (like water and weather) may cause small bits of land to accumulate or erode over time. For example, if soil is gradually deposited by force of water, that is known as accretion.

EXAMPLE: Immobility

A very attractive, well-maintained house will lose value if the neighborhood around it seriously deteriorates because it is immobile.

b. Indestructibility. States that land cannot be destroyed. The concept of indestructibility is the legal basis for neither insuring land nor being able to depreciate it. Its value may be destroyed by changing conditions, but land exists forever. Property insurance insures improvements only, not land. Real estate investment tends to be long term.

c. Uniqueness (nonstandardized; nonhomogeneous). Also known as heterogeneity, and states that every parcel of real property is distinct—land and improvements are not standard. Parcels of land differ in size, shape, location, and appearance. Uniqueness is the legal basis for specific performance lawsuits, or lawsuits that seek to force the sale of land as agreed upon in a valid contract where the seller refuses to carry through with the sale as promised.

Real Estate as Economic Indicator

An economic indicator is a measurable economic factor that changes before the economy starts to follow a particular pattern or trend. Leading indicators are used to predict changes in the economy. Real estate is considered to be an indicator of the economic health of a community or a country.

Investors and economists closely monitor the monthly New Residential Construction Statistics (housing starts) reported by the U.S. Census Bureau. Housing starts (new residential construction projects) are a leading economic indicator because they signal future economic activity. An increase in housing starts suggests economic expansion, as new construction creates demand for loans, building materials, and labor. A decrease often signals a slowdown, making housing starts one of the earliest clues about where the economy is heading.

Other real estate-related economic indicators include foreclosure rates, defaulted mortgage loans, and late payments. If these numbers rise suddenly, it can indicate that the national or local economy is under stress. If these rates are very low, this can indicate that the national or local economy is doing well. Only a good economy can support the high loans and payments necessary to purchase and support a home.

Social Impact of Home Ownership. If more people in a community own their homes, the home values tend to rise because people tend to take more pride in property that they own than in property they rent. Homeownership can lower the crime rates in communities. Activity such as voting and participation in civic organizations is statistically higher among homeowners than renters. In addition, as the property value increases, the chances of being able to sell the home also increases, making it possible for homeowners to improve their lives.

Although business cycles affect the purchase price of a home in a number of ways, one of the primary influences on home prices is the supply and demand in the local real estate market.

Impact of Supply and Demand on Real Estate Prices

Supply and demand is a basic economic principle. If a product is in high demand but in low supply, the price of this product will rise because market conditions will support a higher price.

However, if the product is in low demand and is in high supply, the price of this product will decrease because market conditions are influenced by the high availability of this product.

Supply and demand in real estate is not as easy to balance as it is for manufactured commodities. The construction of more buildings takes time, and there may not be room to build in any given area. You cannot move the buildings to where the buyers are.

Over-supply/Lower Prices. Because real estate is heterogeneous and immobile, you can usually expect there to be a fall in prices when there is an over-supply of homes or land in a given area. You cannot move the overage to another area to keep prices stable. A buyer's market is characterized by slow home sales, lots of available properties and declining home prices.

Under-supply/Higher Prices. If there is not enough land or homes in a given area, then prices will almost always rise. Even if there is the ability to construct more homes, the time delay associated with the construction industry cannot fill the short-term demand, and prices will rise. A seller's market is characterized by rapid home sales, shortages of available homes and rising real estate prices.

Factors Affecting Real Estate Supply and Demand

Some factors that affect the supply and demand of real estate, and consequently, real estate prices, include the following supply and demand factors.

Land has the following five non-physical economic characteristics that influence its value: scarcity, area preference, improvements, investment permanence, and assemblage.

Demand factors

Improvements. Additions made to land that are intended to enhance its value. Improvements include houses and commercial buildings, as well as sewers, sidewalks, and fences. Not all improvements enhance value, and some improvements may be restricted by government or neighborhood associations.

EXAMPLE: Improvements

Developing land into a subdivision may increase its value, while developing it into a landfill may decrease its value along with the value of surrounding properties, according to the economic characteristic of improvement.

Assemblage. Describes how combining two or more contiguous parcels of real estate into a single parcel under the same ownership can increase its overall value.

Assemblage is viable when the combined property will be more valuable than the sum of the individual parcels. Any increase in value resulting from assemblage is known as plottage.

Investment Permanence. Describes the permanence of investment in infrastructure improvements. Infrastructure improvements include sewage, drainage, and electricity systems. Combined with the immobility of the underlying land, these types of improvements produce relatively stable and long-term returns. Infrastructure improvements offer greater options for future development than a specific improvement like a residential home or a commercial building.

Demographics. The main demographic determinants on the demand for housing are: population size and population growth. The more people in the area, the greater the demand for housing. Family size, as well the age and income of the population also play a role in the demand for real estate.

Unemployment/Income. If job opportunities are limited and salaries are low, the demand for homes usually decreases. As unemployment rises, supply may increase because there are a number of homeowners who are forced to sell their homes due to their inability to fulfill the financial obligations that come with owning a home. High unemployment rates also affect demand because prospective homebuyers are deterred from buying due to fears over job security.

Cost/Availability of Credit. If mortgage interest rates are low and financing is relatively easy to obtain, the demand for real estate will usually increase.

Governmental Policies. Federal, state, and local government policies and regulations can influence real estate markets. For example, favorable tax incentives for homeowners can increase demand, while high local property taxes can decrease demand. The local land use controls and zoning policies can affect the supply of land available for residential and other uses.

Area Preference (Situs). Refers to a person's preference for one location over another. The phrase "location, location, location" is another way of explaining how a difference in area preference can cause two physically similar parcels of real estate to have very different economic values. Area preference, also called situs, is often identified as the most important economic characteristic of land.

EXAMPLE: Area Preference

Undeveloped land located in a very rural area will tend to cost far less than undeveloped land in an urban or heavily populated area due to area preference.

Supply factors:

Availability of construction loans and financing. When the market is down or in a recession the interest rates for construction loans or financing will be higher and less affordable to many people.

Availability of land (Scarcity). Economic principle stating that there is a limited supply of land on earth. The concept derives from the fact that the supply of land on earth is fixed and can never be increased. Scarcity can produce an increase or a decrease in the economic value of land depending upon the local supply and demand for land—as available land becomes scarce, its value tends to rise.

Availability of labor and materials. Housing supply is produced using land, labor, utilities, and building materials. If these commodities are readily available, their use will contribute to the overall supply of housing in a market. A scarce supply of one or more of these commodities would contribute to lower supplies and higher prices.

Licensee Must Know the Local Market

It is important for real estate professionals to keep up with trends in interest rates, national home price trends, new housing starts and the other economic indicators that influence real estate markets.

However, the licensee should always keep in mind that real estate is a local business. There can be many forces influencing your local market that will have little or no impact in other areas, and vice versa.

If you are in a market that has industry and a great many job relocations, watch your local businesses and industries carefully for expansion or downsizing.

If your market is a resort community, or contains a lot of second homes, factors that can have great impact may include the local weather trends, aging of the population, and the stock market. Factors that impact discretionary income have more of an influence on this type of market.

Therefore, while the licensee should keep up with the overall national market outlook, supply and demand in real estate will always primarily be a local issue.

Vacancy Rates

Regarding supply and demand, the vacancy rate refers to the total amount of vacant homes available for purchase, grouped by various types of property.

Calculate occupancy and vacancy rates. If there is an undersupply of new construction or available homes the vacancy rate will be low and prices will be high. The lack of available housing drives new construction which in turn drives the vacancy rate higher and prices lower. Once the vacancy rate becomes too high and prices fall too low the construction stops. The cycle simply repeats over time.

This continuous cycle of movement within the real estate market due to fluctuating supply and demand enables licensees more readily identify trends and better prepare their clients.

Progress Check - Escrow Accounts and Characteristics of Real Estate

1. Which physical characteristic of land is the legal basis for not having to insure it?
 - A. Immobility
 - B. Assemblage
 - C. Indestructibility
 - D. Heterogeneity

2. Which is typically identified as the most important economic characteristic of land?
- A. Government policy
 - B. Cost
 - C. Employment/Income
 - D. Situs
3. When a buyer makes an earnest money deposit, until what point does the buyer have a right to demand the deposit be returned?
- A. Until the seller has a legal right to the deposit
 - B. Until settlement/closing day
 - C. Only until the deposit is placed into the escrow account
 - D. Under the impossibility clause, only if the property is destroyed

REAL ESTATE RECOVERY ACT & REAL ESTATE INVESTMENTS

Learning Objectives

- Identify eligible claimants and the procedure for seeking reimbursement from the Real Estate Recovery Fund.
- Identify persons or claims that are not eligible for payment from the Fund.
- Describe statutory payment limits, replenishment thresholds, and funding sources of the Real Estate Recovery Fund.
- Understand license consequences when Fund payments are made on behalf of a licensee.
- Distinguish among common categories of real estate investment property.
- Identify the advantages and disadvantages of investing in real estate.
- Distinguish among market, business, purchasing power, and financial risk.
- Explain the importance of investment analysis in real estate decision-making.

- Calculate and interpret common investment measures such as GRM, NOI, cap rate, and cash-on-cash return.
- Recognize common due diligence issues that may affect investment performance.

Real Estate Recovery Fund (FS 475.483)

Applies to real estate brokerage transactions.

Nature of Fund. The Florida Real Estate Recovery Fund was established to reimburse anyone who suffered monetary damages in a transaction due to the actions of a licensee. To be applicable, the transaction must involve a real estate brokerage transaction related to real property in Florida and the licensee must have:

- Held an active license when the alleged act was committed
- Not been involved as a buyer, seller, landlord, or tenant
- Been acting solely as a licensee, in violation of real estate law or regulations

The Recovery Fund may also be used to reimburse any licensee that is ordered to pay monetary damages, merely because he distributed escrow funds as required by an Escrow Disbursement Order (EDO). The licensee is required to notify the Commission and must diligently defend his actions in court. In such case, the licensee may also be reimbursed for reasonable attorney's fees and court costs in defending his compliance with the EDO.

Funding the Recovery Fund. Assessments are yearly fees added to the licensing fee for new licenses and renewals which help provide recovery funds. This is assessed as a \$3.50 fee for brokers and a \$1.50 fee for sales associates. If the Fund exceeds \$1 million at any time, this collection will be discontinued at the end of the renewal cycle. The assessments will only resume if the Fund has fallen below \$500,000. In addition, all money collected by the Commission as a fine will be transferred into the Fund.

Limitations on Recovery

A person is NOT eligible if:

- Family Relationship
 - Spouse of the licensed broker or sales associate being sued/owes money or their personal representative
- Licensee Involved in the Transaction
 - A broker or sales associate who acted as single agent or transaction broker in the transaction
- Licensee Acting for Own Account
 - Transaction involved a licensee acting as owner or controlling the property (for their own benefit), not acting in a licensed capacity
- Unlicensed Activity
 - Claim is based on a transaction where the licensee did not hold an active license
- Judgment Against a Business Entity
 - Corporation, LLC, partnership, or LLP (Must be against an individual licensee)

Licensees as Claimants

A licensee may only qualify to collect from the Fund if she was NOT acting in her real estate capacity, but was merely a buyer, seller, landlord, or tenant.

Payments from the Fund

A claimant is eligible to seek recovery from the Fund if:

- The claimant has received a final judgment in a Florida Court against a licensee, wherein the case was based on a real estate transaction.
- The claim is made within 2 years from when the violation was or should have been discovered. In no event can a claim be made more than 4 years after the date of the alleged action.

- The claimant has already obtained a writ of execution for the judgment, and has an affidavit showing that:

- (i) the licensee's assets cannot be found; or
- (ii) the amount obtained after selling the licensee's assets was insufficient

A claimant is eligible to seek recovery from the Fund if (cont.):

- ✓ The claimant has a valid reason for being unable to produce such documents, the person must show that after all reasonable action, he discovered no assets (or insufficient assets) to satisfy the judgment.
- ✓ The claimant is not otherwise unqualified to make a claim for recovery (discussed previously) and has demonstrated that the final judgment is not an appeal or, if so, that the appellate proceedings have concluded.

Any person who meets all of the conditions prescribed above may apply to the commission for payment from the Real Estate Recovery Fund:

- An amount equal to the unsatisfied portion of the person's court judgment or \$50,000, whichever is less
- An amount equal to the judgment against the broker or sales associate or \$50,000, whichever is less

Authorized Fund Limit and Fees

Damages Limited. Compensatory damages only. The claimant can only recover actual damages from the Fund. In most cases, this may NOT include triple damages, court costs, attorney's fees, or interest.

Single Transactions: If there are multiple claims related to a single transaction, the amount paid to all claimants may not exceed \$50,000 total.

Multiple Transactions: If there are multiple claims against one licensee across multiple transactions, the amount paid to all claimants may not exceed \$150,000 total.

Insufficient Funds

If at any time the balance in the Real Estate Recovery Fund is insufficient to satisfy any valid claim, or portion of a claim, the commission will satisfy the unpaid claim as soon as a sufficient amount of money has been deposited in or transferred to the fund. When there is more than one unsatisfied claim outstanding, the claims will be paid in the order in which the claims were approved by the commission.

When a claimant receives payment from the Real Estate Recovery Fund, the claimant must assign their additional right, title, and interest in the court judgment (payment) to the commission. Any amount subsequently recovered on the judgment by the commission will be for the purpose of reimbursing the Real Estate Recovery Fund.

Licensee Consequences (FS 475.484)

If a claim is paid to satisfy the judgment against a licensee, that person's license is automatically suspended upon the date of payment from the Fund. The license may not be reinstated until the licensee repays the Fund in full, plus interest.

However, there is no consequence to the licensee if he was merely seeking reimbursement for complying with an EDO. Such license will not be suspended and the reimbursed amount does not need to be repaid to the Commission.

The Real Estate Recovery Fund will also be, on order of the commission, a method of reimbursement to any broker or sales associate who is required by a court to pay monetary damages due to a distribution of escrow moneys in compliance with an escrow disbursement order (EDO) issued by the commission.

If a licensee is claiming for reimbursement due to an EDO, the Commission may pay for reasonable attorney's fees and court costs. Payment is limited to the unsatisfied portion of a claimant's judgment or \$50,000, whichever is less. If a licensee is claiming for reimbursement due to an EDO, the licensee's recovery shall be in an amount equal to the judgment against her or \$50,000, whichever is less.

Real Estate Investments

Real estate as an investment. Real estate investment involves the purchase, ownership, management, rental, or sale of real estate for profit. An investment property could be residential (houses and apartments that can be rented to tenants), commercial (retail and office buildings), industrial (factories and warehouses), or agricultural (farms and ranches).

One of the main reasons to invest in real estate is to **protect against high inflation** over time. This is practical because historically, real estate prices increase (appreciate) at a faster rate than inflation. An investor might also turn to real estate due to the rate of return, tax advantages, leverage, or equity build-up.

Real estate investing can be lucrative, but it's important to understand the risks. Key risks include bad locations, negative cash flows, high vacancies, and problem tenants. Other risks to consider are the lack of liquidity, hidden structural problems, and the unpredictable nature of the real estate market.

Real estate is an asset that is **not as liquid as other investments**. This means that it takes a longer time to sell real estate and turn it into cash than it does to sell other investments, like stocks or bonds.

Real estate is also **capital intensive**, which means that it takes a lot of money to invest to purchase and manage real estate. While an investor holds a real estate property, the profitability of that investment depends on the cash flow it generates. This income will usually come from rent.

Leverage: Act of using borrowed funds to finance an investment (as in a mortgage). The more borrowed funds used, the more "highly leveraged" an investor is (low down payment and high LTV). The investor hopes to realize a profit over the initial purchase price and the cost of borrowing funds.

Appreciation: Increase in the worth or value of property. Investors who buy land solely for its appreciation value usually plan to hold it for long periods of time. Most investors buy real property primarily for its income production, and secondarily for its appreciation potential.

Investment Real Estate Terminology

Equity: The amount financed by the investor's own capital, through cash or other asset transfers, is referred to as equity. Investors usually seek to decrease their equity requirements and increase their leverage, so that their return on investment (ROI) is maximized. Lenders and other financial institutions usually have minimum equity requirements for real estate investments. Typically, this is 20% of the purchase price or appraised value, whichever is the lower (known as Loan-to-Value or LTV).

Liquidity: An estimated measure of the ease with which one may convert an asset into cash. Liquid assets are those assets that can be converted into cash quickly and easily. Gold is an example of a liquid asset. On the other hand, real estate is traditionally a long-term investment (non-liquid asset).

Tax shelter – real estate can be considered a tax shelter as it can be exempt from capital gains taxes.

Analyzing Investment Properties

Investors use several tools to compare one real estate investment to another, or to compare real estate investments to non-real estate investment opportunities. This analysis will help the investor in his determination on whether to purchase an investment property.

Below are some of the most common methods of estimating the investment return for a property:

Gross Rent Multiplier (GRM). Many investors use the gross rent multiplier (GRM) as a rule of thumb to evaluate the investment. To calculate the GRM, you divide the total price of the property by the gross rent.

$$\text{GRM} = \text{Property Price} \div \text{Gross Rent}$$

After an investor has the GRM for a property, he can now compare this particular investment with other properties that are on the market or already sold. The lower the GRM, the better the investment return because the developer gets more rent for each dollar of value. However, the GRM does not take into account vacancy rates or the cost to maintain the property. If an investor had to borrow money to buy the property, it also does not take into account the interest rates on those loans.

Vacancy Rates, Expenses, and Net Operating Income (NOI). Virtually all real estate markets experience some level of vacancy and collection loss, meaning not all potential rental income is actually received.

The Effective Gross Income (EGI) is calculated by subtracting vacancy and collection losses from the gross income.

$$\text{EGI} = \text{Gross Income} - \text{Vacancy and Collection Losses}$$

Investors must also consider the expenses of operating the property, including maintenance, utilities, property taxes, insurance, advertising, management fees, and reserves for replacement of major items.

Net Operating Income (NOI) is calculated by subtracting these operating expenses from EGI and represents the property's income before financing and tax considerations.

$$\text{NOI} = \text{EGI} - \text{Operating Expenses}$$

Capitalization Rate (Cap Rate). The capitalization rate (cap rate) is used by investors to evaluate and compare the potential return of a real estate investment to other properties or investment opportunities.

$$\text{Cap Rate} = \frac{\text{Property Value or Price}}{\text{Net Operating Income (NOI)}}$$

A higher cap rate generally indicates a higher potential return, but it may also reflect higher risk. Investors often compare cap rates across similar properties and may choose an investment with a higher return or consider alternative investments with lower risk if the expected return is similar.

Cash-on-Cash Return (Cash Flow). Investors must consider the cost of borrowing money to purchase an investment, including the cost of servicing the debt. If the interest rate on a loan exceeds the property's cap rate, the investor may experience negative leverage, meaning the cost of borrowing is greater than the return generated by the property.

Cash-on-cash return is calculated as the before-tax cash flow divided by the total cash invested and is expressed as a percentage.

Cash Flow (Before Tax) = NOI – Debt Service (Mortgage Payments)

Cash-on-Cash Return = Before-Tax Cash Flow ÷ Total Cash Invested

This measure focuses only on the cash income relative to the investor's cash investment and does not account for factors such as taxes, appreciation or depreciation, or overall investment risk.

Assessment of Risk

Management and evaluation of risk is a crucial part of any successful investment strategy. Risks occur in many different ways and at every stage of the investment process. In order to minimize that risk, an investor needs to proceed with caution.

For example, an offer to purchase investment property will usually come with several contingencies. These contingencies (inspections, studies, research, etc.) allow an investor to perform his own due diligence on the property. In doing so, he may determine whether the investment is actually a favorable opportunity.

Market Risk: Changes in the market may decrease the value of an investment property, which in turn reduces any equity or liquidity the property might have had when the market was strong.

Business Risk: When a business is the investment property any change in the business (profits, demand, location etc.) could decrease the value of the investment.

Purchasing Power Risk: A decrease in the value of the National currency will in turn decrease the value of an investment property and will also decrease the amount of property that can be bought.

Financial Risk: Changes in the interest rates can have an impact on investment property, the higher the interest rates the lower demand there will be for the property and the property will be more costly to maintain.

Common questions in a real estate investment include:

- What are the returns on investment and cash flows?
- Title to the premises: Are there any title problems?
- Appraisal: What do similar properties cost?
- Zoning: Does the local ordinance allow the activity for which the investor wants to use the property?
- Site problems: Does the property have any environmental contamination, problem soils, or drainage issues?
- Structural/system issues: Is the structure sound and are the systems well maintained?

Progress Check - Real Estate Investments

1. A decrease in the value of the National currency results in _____ risk.
 - A. Market risk
 - B. Purchase power
 - C. Business risk
 - D. Financial risk

2. Annual assessments that sustain the Real Estate Recovery Fund are collected when the fund balance is below:
 - A. \$200,000
 - B. \$300,000
 - C. \$400,000
 - D. \$500,000

3. If an investor is "highly leveraged" the following is true regarding the loan:
- A. The loan is an FHA loan
 - B. PMI is required
 - C. There is a high LTV
 - D. There was a substantial down payment

Module 2 - Business Office Management

BROKERAGE OFFICES, ADVERTISING & BUSINESS ENTITIES

Learning Objectives

- Identify registration requirements for principal, branch, and home brokerage offices.
- Explain when a temporary shelter must be registered as a branch office.
- List statutory sign requirements for brokerage offices.
- Identify advertising requirements and prohibited advertising practices for licensees and brokers.
- Understand broker supervisory responsibility for advertising and office operations.
- Describe licensee obligations when changing employers or registration information.
- Contrast the features, liability, and licensing requirements of common business entities.
- Distinguish between business entities that may register as brokers and those that may not.
- Recognize rules governing team or group advertising.
- Compare ownership and liability structures of sole proprietorships, partnerships, corporations, LLPs, and LLCs.

Brokerage Offices

Broker Office Requirements - Principal Office Location (FS 475.22; FAC 61J2-10.022)

Each active broker must maintain an office, consisting of at least one enclosed room in a permanent building. **Sales associates may not have offices of their own** and must be registered and work out of an office maintained and registered in the name of the employing broker.

If a broker's registered office is located outside the State of Florida, prior to registering the main office or branch office, the broker must agree in writing to cooperate and must cooperate with any investigation initiated in accordance with commission rules including, but not limited to, the broker promptly supplying any documents requested by any authorized representative of the department and by personally appearing at any designated office of the department or other location reasonably requested by the department.

If the department sends, by certified mail to the broker at the broker's last known business address a request to produce any documents or to appear for an interview with an authorized representative of the department and the broker fails to substantially comply with that request or notice, the failure by the broker is a violation of the license law and subject to the penalties.

If a broker desires to conduct business from more than one office, each additional office must be registered as a branch office.

An office is deemed to be a branch office if the name or advertising of a broker (having a principal office located elsewhere) is displayed in such a manner as to reasonably lead the public to believe that the office is owned or operated by the broker.

A fee must be paid for its registration and the physical office must comply with the same criteria set forth for a principal office.

If a broker closes a branch office and, at about the same time, establishes another at a different location, the registration of the office which was closed may not be transferred. The new location is a new branch office which must be registered and the fee paid as though the other had not been closed.

Branch Office Fees

Whenever any licensee desires to conduct business at some other location, either in the same or a different municipality or county than that in which she or he is licensed, such other place of business shall be registered as a branch office, and an annual registration fee prescribed by the commission, in an amount not exceeding \$50, must be paid for each such office.

It will be necessary to maintain and register a branch office whenever, in the judgment of the commission, the business conducted at a place other than the principal office is of such a nature that the public interest requires registration of the branch office.

Any office shall be deemed to be a branch office if the name or advertising of a broker having a principal office located elsewhere is displayed in such a manner as to reasonably lead the public to believe that such office is owned or operated by such broker.

Home Offices (FAC 61J2-10.022)

The required principal or branch office may be in a residence, if not contrary to local zoning ordinances, provided the minimum office requirements are met and the required broker's sign is properly displayed.

Entrance Sign Requirements (FS 475.22)

Each active broker must maintain a sign at or near the entrance of the principal office (and each branch office), which must contain the name of the broker and the trade name, if any.

For a partnership or corporation, the sign must contain the name of the firm or corporation (or trade name), together with the name of at least one of the brokers.

At a minimum, the words “licensed real estate broker” or “lic. real estate broker” must appear on the office entrance signs.

Temporary Shelters (FAC 61J2-10.023)

A temporary shelter is intended only for the protection of sales associates and customers.

Transactions are not to be closed and sales associates are not to be permanently assigned at such location.

The permanence, use, and character of activities customarily conducted at the office or shelter shall determine whether it must be registered.

Guidelines for Advertising (FS 475.01(1)) (FAC 61J2-10.025)

All advertising must be presented in such a way that a reasonable person would know they are dealing with a real estate licensee.

When the licensee's personal name appears in the advertisement, at the very least the licensee's last name must be the same name that is registered with the Commission.

All real estate advertisements must include the licensed name of the brokerage firm.

Remember that the **broker is ultimately responsible** for the activities performed on his behalf at a firm. Sales associates cannot advertise or conduct business in their own name (without the broker).

Therefore, the broker is responsible for all advertising, no matter who prepares the ad. Whether an individual or firm ad, it is expected that all advertisements will be approved by the broker before placement.

No real estate advertisement placed by a licensee will be fraudulent, false, deceptive or misleading.

When advertising on a site on the Internet, the brokerage firm name is required to be placed adjacent to or immediately above or below the point of contact information.

“Point of contact information” refers to any means by which to contact the brokerage firm or individual licensee including:

- mailing address(es)
- physical street address(es)
- e-mail address(es)
- telephone number(s)
- facsimile telephone number(s)

Licensees selling their property by owner – If a licensee is selling their own property they are not required to include the name of their brokerage firm in the advertisement but must disclose their status as a licensed real estate agent to all potential buyers.

False or Misleading Advertising (FS 475.42 (1)(n))

In Florida, real estate advertisements are expected to accurately portray the products and services offered.

If a licensee places, or causes to be placed, a fraudulent, false, deceptive or misleading real estate ad penalties may include:

- First violation: \$250 to \$1,000 administrative fine and 30 to 90-day suspension
- Second and subsequent violations: \$1,000 to \$5,000 administrative fine and 90-day suspension to revocation

Any person who violates the above provisions is guilty of a misdemeanor of the second degree.

Unauthorized Use of Association Names (FAC 61J2-10.027)

No licensee will use an identification or designation of any association or organization having to do with real estate unless entitled to use such identification or designation.

Blind Ads

In Florida, a real estate advertisement that does not contain the identity of the brokerage firm is known as a “blind ad.”

An example of a blind ad would be:

“One Br. Condo for sale. Near shopping and public transportation. Call Jim at 555-8030.”

Blind ads are prohibited because they mislead consumers into thinking they are dealing directly with an owner instead of with a real estate licensee.

Team Advertising (FAC 61J2-10.026)

Team or Group Advertising. Team or group advertising refers to a name or logo used by one or more real estate licensees who present themselves to the public as a team or group, all operating under the supervision of the same broker or brokerage.

Each team or group must designate a licensee responsible for ensuring compliance with Chapter 475, F.S. (state law), and Rule 61J2, F.A.C. (Commission rules), and the broker must maintain a current written record of all team members, updated at least monthly.

Team or group names may include the word “team” or “group,” but may not include terms such as agency, brokerage, company, corporation, LLC, partnership, realty, real estate, or similar wording that suggests the team is a separate brokerage entity.

In all advertising, the team or group name may not be displayed more prominently than the brokerage name, and the advertisement must clearly indicate to a reasonable person that they are dealing with a team or group.

This rule applies to all advertising and does not relieve the broker of any legal responsibilities under applicable law.

Meets Ad Requirements:

“4 bedroom, 2 bathroom home in quiet neighborhood close to schools, call Agent Marlon Smith of Southside Realty Office at 555-2678”

This ad clearly identifies the agent, name of the firm and contact number.

Does NOT Meet Ad Requirements:

“4 bedroom, 2 bathroom home in a quiet neighborhood close to schools, call Agent Smith for further information 555-2678”

This ad does not include the licensee’s full name or the firm name.

Change of Employer

A sales associate must inform FREC about a change of employer within 10 days (FS 475.23).

If a licensee changes to another employer, within 10 days, that person must notify the Commission by filling out a required form with the new employer's name and address.

A license ceases to be in force whenever a licensee changes to another employer. Therefore, the sales or broker associate may not perform real estate services or receive a commission until they are properly registered with their new employer.

A sales associate's obligation of confidentiality with respect to principals or the broker does not end with termination of employment.

A licensee's confidentiality obligations are a fiduciary duty that continue even after the relationship ends, which includes termination of employment.

Duplicating or removing records to take to the new employer constitutes a breach of trust, this is true even if the departing licensee was the person who created the original record or if done for the purpose of taking listings to the new employer.

Removal of records from a previous employer's office constitutes theft.

Business Entities

Types of Business Entities

Entities that may register as a brokerage:

Sole Proprietorship. A sole proprietorship is a simple business structure because the broker is the only owner of the business.

As a result, the broker will have unlimited personal liability for the debts of the business and its wrongful acts (such as negligence, malpractice, torts, etc.).

Since the broker and business are one and the same, the broker will operate the sole proprietorship under his own license number. However, the broker must register the brokerage entity with DBPR.

A broker can dissolve a sole proprietorship by ceasing to operate the business and notifying DBPR. The business also dissolves if the sole proprietor/broker has an expired license, dies, or becomes incapacitated.

General Partnership. A general partnership is an association of two or more partners, each as a general partner with full managerial control of the business.

Each partner is fully liable for all debts of the partnership, and for the wrongful acts of themselves and the other partners.

There must be at least one licensed broker as partner at the brokerage firm, and all partners who perform real estate services for the public must also be licensed as active brokers. All broker partners are responsible for the licensure status of the firm's employees. Therefore, it is the duty of all broker partners to ensure that every sales and broker associate renews his or her license.

Brokers who form a partnership usually do so under a written partnership agreement, but a written agreement is not required.

Sales associates and broker associates **may not** be a partner in the business (only brokers are permitted in Florida).

A partnership may dissolve under the conditions specified in the partnership agreement, which usually provides for dissolution upon the death, disability, or bankruptcy of one of the partners.

Special Requirements for Partnerships (FAC 61J2-4.009; FAC 61J2-4.010)

Ordinarily, when a partner dies/withdraws or a new partner is added, that partnership is dissolved and a new one is created.

For Commission purposes, the partnership will be deemed to be continued if two or more persons continue the business (and at least one is an active broker).

In such case, it is only necessary to cancel, issue, or re-issue registration and licenses in order to reflect the changes of organization.

For example, this might include changing the name or address of the partnership, and re-issuing the licenses of sales and broker associates with the updated information.

If a partnership has only one active broker and that broker dies, resigns, or is otherwise removed as the active broker, the vacancy must be filled **within 14 calendar days**.

Until a new active broker is appointed and registered, no new brokerage business may be performed by the partnership or a licensee registered with the partnership.

The partnership must immediately notify the Commission of the vacancy and of the steps taken to fill it.

Failure to appoint another active broker within 14 calendar days results in the automatic cancellation of the partnership registration, and the licenses of all its sales and broker associates will become involuntarily inactive.

Limited Partnerships. A limited partnership is a partnership that has one or more general partners (with unlimited personal liability and managerial control of the business) and one or more limited partners (with limited liability and no managerial control).

Limited partners invest money or property and share in the profits, but are liable for the debts of the limited partnership only to the extent of their contribution, any assets of the partnership that they possess, and any distribution of the partnership made to them while the partnership is insolvent.

There must be at least one licensed broker as a general partner, and all general partners who perform real estate services for the public must be licensed as an active broker.

Sales associates and broker associates can be limited partners, but cannot be general partners.

In order to dissolve, a limited partnership files a certificate of dissolution with the Florida Department of State, Division of Corporations.

Upon dissolution, the licenses of all its officers, directors, and sales and broker associates become involuntarily inactive.

Ostensible Partnerships Are Prohibited

Even if brokers do not form a formal partnership, they could still be treated as partners (thus liable for the actions and the debts of the other brokers) if they **appear** to the public to be operating as a partnership. This is known as an ostensible partnership.

Ostensible partnerships are **prohibited** because they are considered to be deceitful and misleading to the public.

If two or more brokers create the appearance of a partnership in this manner, the brokers could be subject to disciplinary action and possible license suspension.

For example, it might be an ostensible partnership if two brokers work out of the same office, use the same phone number, the same website, and answer each other's calls.

However, if one or more brokers share the same office space and make it clear that they are separate businesses (using separate signs, separate phone numbers, etc.), they would likely not be considered an ostensible partnership. The test is whether the **general public would reasonably assume** a partnership exists.

For-Profit and Not-for-Profit Corporations. A “for-profit corporation” is created for the purpose of conducting business, such as a real estate brokerage, for profit.

A “nonprofit” or “not for profit corporation” does not have shareholders and may not distribute income to a member, director, or officer except under certain circumstances.

These companies are normally thought of as being created for religious, charitable, or educational purposes.

However, a nonprofit corporation is not necessarily a charitable corporation or one that is tax exempt.

Limited Liability Company (LLC). An LLC is owned and operated by members and is normally governed by the members pursuant to a written operating agreement.

Like corporate shareholders, the members in an LLC enjoy limited liability.

However, a notable characteristic of an LLC is that it has an opportunity to **choose whether it will be treated for tax purposes as an S Corporation, a C Corporation, or a Partnership.**

A broker associate or sales associate may register their license in the name of a professional entity, such as an LLC / PLLC.

Limited Liability Partnerships (LLP). LLPs differ legally from limited partnerships in that limited liability is granted to all partners, rather than just a subset of non-managing “limited partners”.

In an LLP, the partners are not liable for the debts and wrongful acts of the other partners, but only for their own wrongful acts and the debts they cause.

In this type of business, the partners are much like shareholders in a corporation, except they can run the business directly.

There must be at least one licensed broker as a general partner, and all general partners who perform real estate services for the public must be licensed as an active broker.

In order to dissolve, an LLP files a certificate of dissolution with the Florida Department of State, Division of Corporations. Upon dissolution, the licenses of all its officers, directors, and sales and broker associates become involuntarily inactive.

In accordance with FS 475.161, the commission shall license a broker associate or sales associate as an individual or, upon the licensee providing the commission with authorization from the Department of State, as a professional corporation, limited liability company, or professional limited liability company.

Entities That May Not Register as a Broker

The Following Entities Cannot Be Registered as Brokers

- Corporation Sole (an ecclesiastical or church organization)
- Cooperative Associations (can buy and sell their own property, but cannot register as brokers)
- Joint Ventures (two or more parties partake in one single business transaction)
- Business Trust (individual is engaged in transactions involving their own real estate)
- Unincorporated Associations (groups of people associated for non-commercial purposes)

Corporation Sole. A corporation is a legal entity with all the rights, privileges, and responsibilities of a natural person. It is owned by its shareholders and not by partners.

These shareholders have a right to participate in the business profits, through dividends and/or the appreciation of stock, but are not held personally liable for the company's debts and wrongful acts.

Instead, the corporate entity is liable.

A corporation has a board of directors elected by the shareholders, which is responsible for the overall direction and strategy of the business.

Sales associates and broker associates can be stockholders, but **cannot be officers or directors** of a brokerage corporation.

At least one officer must be an active broker for the corporate registration and licenses of its officers, directors, and sales associates to remain valid.

Unlicensed and inactive persons can be officers and directors of a brokerage corporation, but everyone that performs real estate services for the public must be actively licensed as a broker.

A corporation can be dissolved by filing articles of dissolution with the Florida Department of State, Division of Corporations. Upon dissolution, the licenses of all its officers, directors, and sales or broker associates become involuntarily inactive.

Special Requirements for Corporations (FAC 61J2-5.018)

If a corporation has more than one active broker and that broker dies, resigns, or is otherwise removed as the active broker, the corporate registration and licenses of its sales and broker associates will not be affected by the vacancy.

However, if a corporation has only one active broker and that broker dies, resigns, or is otherwise removed as the active broker, the vacancy must be filled within 14 calendar days.

Until a new active broker is appointed and registered, no new brokerage business may be performed by the corporation or a licensee registered with the corporation.

The corporation must immediately notify the Commission of the vacancy and of the steps taken to fill it.

Failure to appoint another active broker within 14 calendar days results in the automatic cancellation of the corporate registration, and the licenses of all its sales and broker associates will become involuntarily inactive.

Cooperative Association. Form of property ownership governed by state law, which is composed of single units in a multi-unit real estate development.

In physical appearance, cooperatives and condominiums often resemble one another. However, the methods of ownership differ substantially.

Florida's cooperative laws are listed in Chapter 719 of the Florida Statutes. Collectively known as the "Cooperative Act," these laws establish rules for creating, operating, and selling cooperatives in the state.

For example, before selling or leasing a cooperative unit for more than 5 years, the prospective buyer/lessee must receive certain disclosures. This includes, but is not limited to, copies of:

- cooperative by-laws, covenants, and restrictions
- estimated operating budget
- schedule of expenses
- floor plan of the unit
- map of the buildings and common areas
- applicable leases
- maintenance contracts

The contract for sale or lease must also contain disclosure of the buyer's cancellation rights, among other things.

Joint Venture. A joint venture is a form of business where two or more parties combine their efforts to complete a single business transaction. This is specifically intended to be a temporary partnership, not an ongoing business relationship.

If real estate brokers combine to create a joint venture and each individual is licensed, the joint venture doesn't have to be registered.

Business Trust. A business trust is often created when an individual is engaged in transactions involving their own real estate (usually for investment purposes).

With this type of entity, the trust itself becomes the owner of the real estate, a trustee is appointed to manage the business, and any profits are divided among one or more beneficiaries.

Any employee who buys or sells real estate for the trust must be a licensed broker.

Unincorporated Associations. An unincorporated association is an association of two or more persons formed for some religious, educational, charitable, social or other non-commercial purpose.

Whenever two or more people decide to work together to accomplish a common purpose, they've formed an unincorporated association.

If the mutual purpose is to generate a profit, then the unincorporated association they've formed is actually a partnership or a joint venture.

Ownership. A corporation, partnership, or land trust holds title to the land and improvements.

When a purchaser pays the agreed upon price for a particular unit, he receives stock in the corporation (personal property) and a proprietary lease to a particular unit (again, personal property).

The proprietary lease gives the stockholder the right to occupy and use a particular unit for the life of the corporation.

Proprietary means "owner," and leases in a cooperative are called proprietary leases because the tenant is also an owner by virtue of his stock ownership in the corporation (or partnership or trust).

When a unit is sold, the proprietary lease is assigned to the buyer along with the seller's stock.

In a cooperative, real estate taxes and mortgages are liens against the entire parcel of real estate. Therefore, in the event of foreclosure, the entire property is threatened.

Management

The corporation, partnership, or trust that holds title to the entire cooperative project (units and common areas) manages the property according to its articles of incorporation, by-laws, covenants, restrictions, and house rules.

In the case of a corporation, the governing body is usually the corporation's board of directors.

The board of directors is empowered by its by-laws to set a price on each unit in the building.

A sales associate is prohibited from being an officer or director in a real estate brokerage corporation, or a general partner in a brokerage limited partnership.

Progress Check - Brokerage Offices, Advertising & Business Entities

1. Ostensible partnerships are prohibited because:
 - A. Sales associates cannot be general partners
 - B. Broker associates cannot have managerial control
 - C. They are misleading to the public
 - D. No one has strict liability for the debts

2. Regarding corporations, which of the following is not true?

- A. Sole brokers must be replaced within 30 days
- B. They are not allowed to register as brokers
- C. Sales associates can be corporation stockholders
- D. Failure to replace a sole broker in a timely manner results in automatic registration cancellation

3. In what case does a broker have to agree in writing to cooperate with investigations prior to registering a brokerage office?

- A. When registering a home office
- B. When registering an out of state office
- C. When registering a branch office
- D. When registering all brokerage offices

AGENCY RELATIONSHIPS & FIDUCIARY DUTIES

Learning Objectives

- Identify residential transactions subject to brokerage disclosure requirements and activities exempt from disclosure rules.
- Define residential transaction under Florida law.
- Distinguish among no brokerage, single agent, and transaction broker relationships.
- Describe how agency relationships may be created by express agreement, implication, ratification, or estoppel.
- Distinguish between clients and customers and the duties owed to each.
- List and explain fiduciary duties owed in authorized brokerage relationships.
- Describe disclosure timing and procedures for authorized relationships.

- Explain the procedure for transitioning from single agent to transaction broker.
- Describe designated sales associate requirements in qualifying nonresidential transactions.
- Identify events that terminate brokerage relationships.
- Explain post-termination duties of confidentiality and accounting.
- Understand broker record retention requirements for agency-related records.

Agency Relationships

Concept of Agency

Florida Agency Law. When a person authorizes another person to act on his behalf, that person has created an agency relationship. The person delegating the authority is the principal (client), and the person to whom the authority is delegated is an agent (licensee).

The relationship between a client and an agent usually arises by an express agreement, wherein the client confers written authority upon the agent to act for him or her in dealing with third parties in exchange for a fee.

Agency law is primarily derived from common law. Common law arises over time from judicial precedent (case law) and custom, not from written statutes.

Under common law, the agency relationship is also a fiduciary relationship. If a person serves as an agent, that agent has a duty of loyalty to the principal (to act in his best interests).

Florida Statutory Law replaces portions of the common law of agency and where the two are in conflict, the Florida statutes control.

Terms that Accompany Agency Relationships:

“Dealing at arm’s length” is where a buyer and a seller deal from equal bargaining positions in a formal manner without trusting solely to the other’s fairness and integrity.

Caveat emptor or “buyer beware” is a common law doctrine that places the burden on buyers to reasonably examine property before making a purchase.

A buyer who fails to meet this burden is unable to recover for defects in the product that would have been discovered had this burden been met.

Dual agency is a situation where the same agent (broker or firm) represents multiple parties (buyer and seller) with competing interests in the same transaction.

Dual agents owe agency duties to both parties. However, it is difficult to carry out these duties because the buyer and seller have opposing interests and are in competition with one another.

Florida does not permit dual agency. Therefore, a Florida real estate licensee may NOT operate as a disclosed or undisclosed dual agent.

Subagency “the agent of an agent” is when agents (brokers) appoint subagents (sales associates) where the client expressly authorizes or where the law otherwise permits.

The subagent may then perform tasks for the primary agent’s clients.

A subagent, lawfully appointed by a listing broker, must represent the client (the seller) in the same manner as the primary agent (in the real estate context, the listing broker).

Because an agency relationship exists between the broker (agent) and the seller (client), both parties have duties to one another.

Types of Agency Relationships in General Business Dealings

Universal Agent. One who is authorized to perform a variety of acts necessary to effectuate a variety of transactions on behalf of another.

Universal agency is a much broader grant of authority than either the special (authorized to complete a specific act) and general agent (authorized to complete any and all acts necessary for a specific transaction).

An unlimited power of attorney is an example of universal agency.

Courts do not view universal agency favorably due to the broad scope of power vested in the agent.

Universal agents have authority to legally obligate clients.

A General Agent. A person authorized to perform any and all acts associated with a specific service (property manager).

General agents have authority to legally obligate clients (may contract on client's behalf).

EXAMPLE: General Agent

A property manager authorized by an owner to manage a real estate project on a continuing basis is the general agent of the owner. As such, he is authorized to perform many different types of acts on behalf of the owner in order to carry out his management function.

Likewise, a licensed sales associate is the general agent of his employing broker, which authorizes him to perform many different acts necessary to effectuate the sale of real estate.

Special Agent. A person authorized to perform a particular act or transaction pursuant to an agency agreement.

In most brokerage transactions, the broker acts as a special agent.

Special agency limits the broker to certain activities specified in the listing agreement.

Special agents cannot legally obligate clients (cannot accept an offer on client's behalf).

EXAMPLE: Special Agent

If the seller is the client, the broker can offer the property for sale, but cannot actually sell it.

A special agent has authority to carry out one specific act only.

Creation of Agency Relationships

Express Agreement. An agency relationship may be created by express agreement, which is clearly stated orally or in writing by the parties.

Although listing agreements (which create an agency relationship by express agreement) may be oral, it is preferable to have a written listing signed by both parties.

In a listing agreement, a broker (agent) and a client (seller) enter into an agency agreement for the purpose of selling real estate.

While brokers may delegate agency authority to a sales associate, the underlying listing agreement is between the broker and the client—not the sales associate and the client.

A brokerage relationship is established through the licensee’s role and required disclosures, typically arising when the licensee begins providing real estate services.

However, compensation alone does not create a brokerage relationship. Also, merely using common source information, such as a multiple listing service (MLS), does not create a brokerage relationship. That is, an agent who represents a buyer can use an MLS to locate property without creating an agency relationship with a listing seller.

Implied Agreement. Agency relationships may also be created by actions or statements that are short of an express agreement.

If two people act as if an agency relationship exists, chances are that if called upon to make a decision, a court will rule that an agency relationship exists, even without a formal written agreement.

Also known as ostensible agency, implied agencies may be unintended and may create conflicting duties (dual agency).

EXAMPLE: Implied Agreement

Lindsey, the Broker, meets Sal, the Buyer, at an open house. As Sal is leaving, apparently uninterested in the property, Lindsey tells Sal: “There is a place for sale down the street that is exactly what you are looking for. Meet me there at 3 and I will give you a tour.” If Lindsey is the listing agent for both properties, she risks creating an undisclosed dual agency with Sal by implying that she will represent his interests.

Ratification: Agency relationships may arise by ratification. To ratify means to approve, sanction, or validate.

Through ratification, a principal may create an agency relationship where an agent performs for the principal without the principal's consent, but the principal subsequently approves or ratifies the agent's conduct.

EXAMPLE: Ratification

A broker performs a service for a buyer. It is an unauthorized service, but the buyer does not discourage the broker and later shows approval. This buyer may owe the broker a commission, as a court could decide that an agency relationship was established by ratification.

Estoppel. Agency relationships may also be established by estoppel.

Judges apply estoppel on a case by case basis, which makes it difficult to predict.

However, once applied, estoppel prevents (or stops) one from asserting that there was no agency relationship.

Estoppel often involves misleading conduct, or conduct that would otherwise reasonably lead a person to rely on a given set of assumptions (avoids unfairness when one party relies on the words or actions of another to his detriment).

EXAMPLE: Estoppel

A does something (or says something) that leads B to believe that C is A's agent, working on A's behalf. If B relies on this information, then A creates an ostensible agency (one that appears to exist) and may become liable for the acts of his agent, C. That is, A may be estopped (prevented) from later trying to deny the agency relationship he created by virtue of his actions.

Fiduciary Relationships

Nature of Fiduciary Duties. A fiduciary is a person holding a position of trust and confidence by virtue of their representation of another (agent representing a principal).

A fiduciary duty is a duty imposed on a fiduciary by the common laws of agency.

The common law imposes fiduciary duties on agents both during and after client representation.

Customer vs. Client

A client is a person, also known as a principal, who has an agency relationship with an agent.

A buyer may be the client of a buyer's agent, a seller may be the client of a seller's agent, and a property owner may be the client of a property manager.

A customer is a person who is NOT in a brokerage relationship with respect to a particular broker, but for whom a real estate agent may perform ministerial acts in a real estate transaction.

Agents Fiduciary Duties to Customers

There are some duties that an agent may owe to persons that they do not formally represent (customers), including:

- fair and honest treatment of buyers and sellers (not knowingly providing false information)
- disclosing material adverse facts regarding the physical condition of property that are actually known by the agent
- ability to perform ministerial acts (unless prohibited by law or the brokerage relationship)
- representing multiple clients at different times
- disclosure of brokerage relationship (as required by state law)
- disclosing the intent to occupy (agent engaged by a buyer of residential property must disclose to a seller the buyer's intent to occupy the property as a principal residence)

Traditional Common Law Agency Duties (OLD CAR)

Agents Fiduciary Duties to Clients:

Obedience. Fiduciary duty that requires an agent to follow all lawful client instructions. An agent may propose alternative action, but the client must have final approval. However, an agent cannot carry out any illegal request; to do so would violate the duty of loyalty.

Agents who cannot comply with lawful client instructions must withdraw from the agency relationship.

EXAMPLE: Obedience

Broker Fred is in the process of listing Bigoted Bob's home when Bigoted Bob mentions that even though it may be a violation of the law, he does not want his home shown to minority families.

Because this directive violates fair housing laws, Broker Fred cannot comply with the request and must inform Bob that following his request would violate state and federal law.

Loyalty. Fiduciary duty imposed on an agent during client representation.

The duty of loyalty is the most fundamental fiduciary duty and requires the agent to place the client's interests above the interests of the agent or any other person.

Disclosure. Disclosure is a fiduciary duty requiring the agent to fully and timely disclose all known material facts that could affect the client's decision in a real estate transaction. This includes not only property-related issues (such as latent defects) but also transactional information, like the other party's willingness to negotiate, competing offers, or any facts that could impact price or terms.

The agent must ensure the client is never operating at a disadvantage due to lack of information, while still complying with legal limits and duties owed to other parties.

Confidentiality. Confidentiality is the fiduciary duty that requires an agent to protect the client's private and sensitive information, even after the agency relationship ends.

This includes information such as the client's motivation to buy or sell, financial situation, willingness to accept less (or pay more), or any personal circumstances that could weaken their negotiating position.

The agent must not disclose this information without the client's informed consent, unless disclosure is required by law, ensuring the client's bargaining power and privacy remain protected throughout and beyond the transaction.

Accounting. Fiduciary duty that requires an agent (broker) to protect and account for all money and property held on behalf of the client.

Commingling is the act of mixing or mingling entrusted client or customer funds with personal or business funds (deposit into the same account), and conversion is the act of stealing (using, misappropriating) entrusted client or customer funds; both violate the duty of accounting.

This includes any documents such as deeds, title policies, abstracts, or mortgages given to the agent by the client.

EXAMPLE: Accounting

Buyer Billy offers to purchase Seller Suzy's property for \$200,000. Seller Suzy accepts Billy's offer. Billy pays \$10,000 in earnest money to Suzy's broker, Barbara. It so happens that Barbara's commission will be \$10,000. However, if Barbara fails to place Billy's earnest money into an escrow account, she will breach her duty of accounting.

Escrow accounts are a large part of the agent's duty of accounting.

- ***Duration:*** The duty of accounting applies both during and after the agency concludes (terminates).
- ***Escrow Accounts:*** Most states require that if real estate agents (brokers) hold money or documents on behalf of another until specified terms and conditions have been satisfied, such items must be placed in an escrow account. Generally, sales associates may not act as escrow agents, although they may accept money and documents for escrow on behalf of their employing broker (firm). Escrow accounts are regulated by state law and any agreement with/between the parties.

EXAMPLE: Escrow Accounts

If escrow funds are used to purchase a certificate of deposit, it is commingling to pledge the certificates, or if the original certificate is not under the direct control of the broker at all times.

Reasonable Care and Due Diligence. Fiduciary duty that requires an agent to act as a competent professional and to make reasonable efforts to keep the client informed.

Essentially, the agent must act with the same degree of competence that any reasonable agent would exercise under similar circumstances.

This means that the agent diligently represents the client with all the customary tools and available information.

However, while brokers and sales associates must be more knowledgeable than the average person, they are not required to have the knowledge of other professionals such as lawyers, engineers, or accountants.

Agents should advise clients to seek the advice of such professionals whenever necessary in order to avoid a heightened standard of care or a violation of state law.

EXAMPLE: Reasonable Care and Due Diligence

Sales Associate Jim works for Broker Pat and exclusively sells residential properties. A potential client approaches Sales Associate Jim about selling his commercial office building. If Sales Associate Jim decides to handle this transaction, he will be held to the skill and knowledge of the typical commercial property agent, rather than skill and knowledge required of the typical residential property agent. If Sales Associate Jim fails to use the special knowledge and skill expected of an agent qualified to handle commercial property, he will breach his duty of reasonable care and due diligence.

Fiduciary Duties Following Agency Representation

Unless the agent and the client otherwise agree in writing, the agent owes no further duties to a client after termination, expiration, or full performance of the brokerage relationship, except to:

- account for all moneys and property relating to the brokerage relationship; and

- keep confidential all personal and financial information received from the client during the course of the brokerage relationship, and any other information that the client requests during the brokerage relationship to be maintained confidential, unless otherwise provided by law or the client consents in writing to disclosure.

Brokerage Relationships Determined by Broker

Generally, the parties in an agency relationship that was created to purchase or sell property are the client and the real estate broker (NOT the sales associate and client).

A real estate sales associate working under the listing or buying broker may serve as a sub-agent of his or her broker.

The broker is engaged on behalf of the client to procure a seller, buyer, option, tenant, or landlord that is ready, able, and willing to sell, buy, option, exchange, or rent real estate.

In a listing agreement, a broker (agent) and a client (seller) enter into an agency agreement for the purpose of selling real estate.

While brokers may delegate agency authority to a sales associate, the underlying listing agreement is between the broker and the client—not the sales associate and the client.

Disclosure Requirements

All states require that brokers and sales associates disclose who they represent to potential buyers and sellers.

Making a proper and timely agency disclosure is an attempt to avoid misleading or confusing potential buyers and sellers.

Proper and timely disclosures will also avoid creating an implied agency relationship, which would carry various duties and liabilities for the agent.

States require various methods of disclosure and impose various substantive requirements for the disclosures.

Generally, such disclosures must occur before the agent and the party have substantive discussions about the property or transaction, and before any confidential information is disclosed to the agent.

Some states require that disclosures be made on standard forms, while others impose specified boiler plate language that must appear in any agency disclosure.

Applicability: The disclosure requirements apply to all residential sales, defined as:

- the sale of improved residential property of four units or fewer
- the sale of unimproved residential property intended for use of four units or fewer
- the sale of agricultural property of 10 acres or fewer

Disclosure requirements do not apply to:

- When a licensee knows that the potential seller or buyer is represented by a Single Agent or a Transaction Broker
- When an owner is selling new residential units built by the owner and the circumstances or setting (location of sales office, office signage, placards, ID badges worn by owner or agent), should reasonably inform the potential buyer of the status of the owner or agent
- Non-residential transactions
- To the rental or leasing of real property (unless an option to purchase all or a portion of the property improved with four or fewer residential units is given)
- To a bona fide “open house” or model home showing that does not involve eliciting confidential information, the execution of an offer or an agreement for representation, or negotiations concerning price, terms, or conditions of a potential sale.
- To unanticipated casual conversations between a licensee and a seller or buyer which do not involve eliciting confidential information, the execution of an offer or an agreement for representation, or negotiations concerning price, terms, or conditions of a potential sale.

- To a licensee responding to general factual questions from a potential buyer or seller concerning properties that have been advertised for sale.
- To situations in which a licensee's communications with a potential buyer or seller are limited to providing general factual information (oral or written) about the qualifications, background, and services of the licensee or the licensee's brokerage firm.
- Auctions
- Appraisals
- Dispositions of any interest in business enterprises or business opportunities, except for property with four or fewer residential units.

Authorized Broker Relationships

No Brokerage, Transaction Brokerage, and Single Agency Relationships. Under the Florida statute governing real estate brokerage, a real estate licensee may enter into a brokerage relationship with potential buyers and sellers as either a transaction broker or as a single agent.

As an alternative, a licensee may be in a “no brokerage” relationship with a buyer or seller.

Finally, in a non-residential transaction between buyers and sellers (as well as landlords and tenants) meeting certain criteria, a sales associate may act as a “Designated Sales Associate.”

Each role carries certain duties for the licensee and mandatory disclosures (discussed below).

Non-Representation

No Brokerage Relationship (NBR). If a licensee is not acting as a transaction broker or a single agent, she may act in a “no brokerage” relationship capacity.

In a NBR, the licensee represents no one, but has minimal duties in order to make sure the parties are treated fairly. In essence, this is a customer relationship.

Duties:

- Dealing honestly and fairly
- Disclose all known facts that materially affect the value of residential property which are not readily observable to the buyer
- Accounting for all funds entrusted to the licensee

Disclosure Requirements. Duties of a licensee who has no brokerage relationship with a buyer or seller must be fully described and disclosed in writing to the buyer or seller.

The disclosure must be made before the showing of property.

When incorporated into other documents, the required notice must be of the same size type, or larger, as other provisions of the document and must be conspicuous in its placement so as to advise customers of the duties of a licensee that has no brokerage relationship with a buyer or seller, except that the first sentence of the information identified in the disclosure notice must be printed in uppercase bold type.

Single Agency. licensee in a single agency relationship is a broker who represents, as a fiduciary, either the buyer or seller, but not both in the same transaction.

“Fiduciary” means a relationship of trust and confidence between a broker and the seller or buyer.

Duties:

- (a) Dealing honestly and fairly
- (b) Loyalty
- (c) Confidentiality
- (d) Obedience
- (e) Full disclosure
- (f) Accounting for all funds
- (g) Skill, care and diligence in the transaction
- (h) Presenting all offers and counteroffers in a timely manner
- (i) Disclosing all known facts that materially affect the value of residential real property that are not readily observable

Disclose the single agent relationship before, or at the time of, entering into a listing agreement or an agreement for representation or before showing the property, whichever occurs first.

The written disclosure may be presented as either a separate and distinct document or included as part of another document, like a listing agreement or other agreement for representation.

When incorporated into other documents, the required notice must be of the same size type, or larger, as other provisions of the document and must be conspicuous in its placement so as to advise customers of the licensee's duties, except that certain specified information must be printed in uppercase and bold type.

The specific wording for each disclosure is listed in Section 475.278 of the Florida Statutes.

Transaction Broker Relationship. Presumption of Transaction Brokerage - It is presumed that all licensees are operating as Transaction Brokers unless a Single Agent or a No Brokerage Relationship is established, in writing, with a customer.

A transaction broker provides a limited form of representation to a buyer, a seller, or both in a real estate transaction, but does not represent either in a fiduciary capacity or as a single agent. This form of limited representation means that a buyer or seller is not responsible for the acts of the licensee.

Further, parties using a transaction broker are giving up their right to the undivided loyalty of the licensee.

This aspect of limited representation allows a licensee to facilitate a real estate transaction by assisting both the buyer and the seller, but a licensee will not work to represent one party to the detriment of the other party when acting as a transaction broker to both parties.

Duties include:

- (a) Dealing honestly and fairly
- (b) Accounting for all funds

- (c) Using skill, care, and diligence in the transaction
- (d) Disclosing all known facts that materially affect the value of residential real property and are not readily observable to the buyer
- (e) Presenting all offers and counteroffers in a timely manner, unless a party has previously directed the licensee otherwise in writing
- (f) Limited confidentiality, unless waived in writing by a party. This limited confidentiality will prevent disclosure that the seller will accept a price less than the asking or listed price, that the buyer will pay a price greater than the price submitted in a written offer, of the motivation of any party for selling or buying property, that a seller or buyer will agree to financing terms other than those offered, or any other information requested by a party to remain confidential
- (g) Any additional duties that are mutually agreed to with a party

Consent to Transition from Single Agent to Transaction Broker

A single agent relationship may be changed to a transaction broker relationship at any time during the relationship between an agent and principal, provided the agent gives the transition disclosure and the principal consents to the transition before a change in relationship.

Note that there is a specific written disclosure requirement if the parties are transferring from a Single Agent relationship to a Transaction Broker relationship.

To obtain proper written content for a change of relationship, the licensee must use the standard disclosure found in FS 475.278(3).

Designated Sales Associate. In any NON-RESIDENTIAL transaction where the buyer and seller (or landlord and tenant) have assets of \$1 million or more, the broker at the request of the customers may designate sales associates to act as single agents for different customers in the same transaction.

A DSA has the same duties as a SA, including the SA disclosure requirements.

In addition, the buyer and seller as customers must both sign another disclosure. These disclosures must state that their assets meet the \$1 million threshold and request that the broker use the designated sales associate form of representation.

Record Keeping and Retention (FS 475.5015)

Each broker shall preserve at least one legible copy of all books, accounts, and records pertaining to her or his real estate brokerage business for **at least 5 years** from the date of receipt of any money, fund, deposit, check, or draft entrusted to the broker.

In the event no funds are entrusted to the broker, the broker must preserve such records for at least 5 years from the date of execution by any party of any listing agreement, offer to purchase, rental property management agreement, rental or lease agreement, or any other written or verbal agreement which engages the services of the broker.

If any brokerage record has been the subject of or has served as evidence for litigation, relevant books, accounts, and records must be retained for **at least 2 years** after the conclusion of the civil action or the conclusion of any appellate proceeding, whichever is later (but in no case less than a total of 5 years, as stated above).

Documenting brokerage relationship disclosure - All disclosure documents required for a No Brokerage Relationship, Single Agency, Transition to Transaction Brokerage, or Designated Sales Associate must be retained by the real estate licensee in all transactions that result in a written contract to purchase and sell real property.

Terminating Brokerage Relationship

Act of the Parties

Because agency representation is a personal service, it may be terminated by either party at any time (courts will not enslave someone to perform).

However, if the agency is terminated without agreement and before the stated expiration date, one party may be in breach of the agency relationship.

The following acts of the parties can terminate an agency agreement, which may or may not create a claim for damages:

- mutual consent (no breach)
- completion of the objectives (no breach)
- renunciation (may result in breach)

- abandonment by the Agent (listing agent fails to make an attempt to sell—may result in a breach)
- revocation by the client (may result in a breach)

Operation of Law

The following situations can terminate an agency by operation of law:

- mental incompetence of either party (no breach)
- death of either party (no breach; however, the death of the sales associate will not terminate the agency agreement because it is with her broker)
- destruction or disposition of the subject of employment (no breach)
- bankruptcy of either party (may result in a breach)
- expiration of time (no breach)

Progress Check - Agency Relationships & Fiduciary Duties

1. In a no-brokerage relationship which of the following duties is not required?

- A. Accounting
- B. Honesty
- C. Confidentiality
- D. Material fact disclosure

2. Caveat emptor is a common law doctrine that states:

- A. A buyer and a seller have equal bargaining positions
- B. Principal brokers have delegation authority
- C. Agents may not act as dual agents
- D. A buyer should inspect a property prior to purchase

3. A broker may appoint a designated sales associate for which of the following transactions?

- A. Residential estate sale with total assets of \$1.7 million
- B. Sale of a hair salon with combined assets of \$550,000
- C. A Ben & Jerry's franchise with total assets of \$1.2 million
- D. A condo with combined assets of \$750,000

CONTRACTS

Learning Objectives

- Identify and explain the essential elements required to form a valid contract.
- Distinguish among common contract classifications, including formal/informal, bilateral/unilateral, express/implied, and executory/executed contracts.
- Explain the Statute of Frauds and when real estate agreements must be in writing.
- Differentiate among void, voidable, and unenforceable contracts.
- Describe how offers are made, accepted, rejected, countered, and terminated.
- Explain the legal purpose of consideration in contract formation.
- Recognize common contract defenses such as incapacity, minority, intoxication, duress, and illegality.
- Distinguish between fraud and misrepresentation, including fraud in the inducement and fraud in the factum.
- Explain the effect of conditions and contingencies in real estate contracts.
- Understand estoppel and reliance concepts that may affect enforceability.

Contracts in General

A contract is a **legally enforceable** agreement between competent parties who agree to perform, or refrain from performing, specified acts.

A legally enforceable contract represents the exact meeting of the minds or "mutual assent" (the agreement) of the parties involved.

Real estate is a business of contracts—listing contracts, sales contracts, option contracts, leasing contracts, development contracts, installment sales contracts, and financing contracts to name a few.

In addition to elements specific to certain real estate contracts (such as a clear description of the subject property), there are three basic elements to any enforceable contract.

Elements of a Valid Contract. All of the following must exist to create a contract:

- An offer and acceptance
- Consideration (something of value)
- A lack of any defenses (something that might cancel a contract or prevent it from being formed)

These elements are intended to ensure that there is an understanding, or a “meeting of the minds” between two or more parties.

Statute of Frauds

The Statute of Frauds is a state law based on the common law, which requires certain contracts to be in writing in order to be enforceable.

The statute of frauds requires all real estate contracts for the sale or transfer of land, or the transfer of any ownership interest in land for **longer** than one (1) year, to be in writing and signed in order to be enforceable.

As a result, courts will not enforce oral contracts for the sale of land even if otherwise valid (that is, even if they contain all essential contract elements).

All real estate leases for more than one year must also be in writing and signed in order to be enforceable. Finally, oral real estate leases for a period of one year or less are enforceable and need not be written under the statute of frauds.

Statute of Limitations

The Statute of Limitations is a state law that establishes time limits on one's ability to bring a legal action, including an action to enforce a contract.

If a lawsuit is filed to seek enforcement of a contract beyond the limitations period, courts will not hear the suit. These laws are intended to facilitate commerce by limiting liability. Time periods differ by state and topic.

Void, Voidable and Unenforceable Contracts

A defense is a material defect which, if proven, either prevents a contract from forming (void) or renders an otherwise valid contract unenforceable (voidable).

Even where there is an offer and acceptance that is supported by consideration, there may not be a contract.

Void and Voidable Distinction:

Certain defenses may exist that prevent a contract from being formed in the first place. Other defenses permit a party to escape liability from the contract, even though the contract is valid.

In either case, these two types of defenses result in either a contract that is **void** (a theory that the contract was never properly formed) or a contract that is **voidable** (a theory that a contract is valid, but fairness dictates that one may avoid liability to perform if they prove the defense).

Common defenses which render a contract void or voidable include:

- incompetency
- misrepresentation
- mistake
- illegality
- minors
- under the influence of alcohol
- duress

Contracts Defenses

Incompetency

If established, results in either a void or voidable contract depending upon whether there is a limited capacity or a lack of capacity. Generally, courts assume people are competent enough to enter into contracts with one another. However, some people are legally unable to contract because they lack “capacity.” As a result, their contracts are void.

People that entirely lack capacity to contract include those that are legally insane. Others have only a limited capacity to enter into contracts. These contracts are voidable, which means that one must take steps to avoid responsibility for the contract. Both minors and intoxicated persons are examples of those with a limited capacity to contract.

Legal Insanity: One who has been adjudicated incompetent or insane by a court. Such persons have no capacity to contract, and may not be a party to a contract because legally incompetent individuals cannot be expected to understand the terms of a contract.

Therefore, a legally incompetent person cannot agree to a contract because an agreement requires understanding. Without agreement, there is no meeting of the minds. The contracts of the legally insane are void (no capacity to contract; no meeting of the minds).

However, if an otherwise legally insane person is determined (by a court) to have been of sound mind at the time of contracting (lucid interval), then the contract is enforceable.

Lucid interval is the period of time in which a legally incompetent person is judged by a court to have been temporarily of sound mind (lucid). If an otherwise legally insane person contracts during a lucid interval, then the resulting contract remains valid even if the person subsequently returns to insanity.

Non-Legal Insanity: Person who is actually insane, but has not been declared insane by a court. Persons who are insane **without** a court declaration possess a limited capacity to contract. Such contracts are therefore voidable and not void.

Minors

One who is under 18 years of age (in most states). In terms of contracting, minors have a limited capacity. As such, contracts by minors are generally voidable.

This means that a minor may enter into a contract, but he may escape liability for the contract if he subsequently rejects it. The minor must reject (disaffirm) the contract within a reasonable time of becoming an adult, or the contract will be binding.

The contracts of minors for certain necessities (food, clothing) are neither void nor voidable (obligates the minor; case by case determination by a court under specific facts).

Florida minors **are allowed** to enter into contracts but the contract is voidable by the minor.

Intoxication

If established, states that persons who were intoxicated at the time of contracting have a limited capacity to contract. Such contracts may be voidable **by the intoxicated person** if they act promptly. If they do not act promptly to cancel the contract, their inaction will be taken as agreement, and the contract will be valid.

Duress

A contract defense that occurs when a party is forced or coerced into entering a contract through wrongful threats, intimidation, or undue pressure. Because true voluntary consent is lacking, there is no genuine meeting of the minds.

Contracts entered into under duress are **voidable** (not automatically void) at the option of the injured party, who must take action to rescind the contract.

Essential Elements of a Valid Contract

Contractual capacity of the parties.

All parties to a contract, at a minimum two people are necessary for a contract, must be of legal capacity to participate in the contract. Parties to a contract must be of sound mind (mental capacity) and have legitimate authority to enter into and sign a contract.

Offer and Acceptance

An offer is a promise from one party (offeror) to enter into a binding agreement with another party (offeree), subject to specified terms or conditions (“I will buy your house for \$200,000”).

Once presented, an offer becomes a contract if it is **accepted as is**, signed, supported by consideration, and has a lack of any contractual defenses.

A seller is not required to accept any offer. Even if the offer contains all the requirements stipulated in a listing agreement, the seller can refuse the offer or counteroffer. Remember, a seller’s decision is not based on price alone, so it should be considered within the full context of the offer, including terms, contingencies, and overall risk.

For example, perhaps the higher offer included an earlier closing date which was not possible for the seller. Or, a lower offer might be a cash offer with no home inspection request which might suit the seller greatly.

There is no law that requires a buyer or seller to communicate in writing his or her decision to reject the other’s offer. There is no Florida law that requires the seller to negotiate with each buyer in the order in which the offers were received. If a seller receives multiple offers on a property, the seller is technically permitted to counter more than one offer at a time, in writing.

However, doing so can be complicated.

If the seller counters in writing more than one offer and each counter is accepted before the seller is able to communicate an intent to withdraw her counter to one of the buyers, the **seller could be bound to multiple written contracts** and thus have potential liability to those buyers.

Acceptance. The act of declaring a desire to create a contract consistent with a specific offer (offers must be accepted as the offer specifies). Unless otherwise specified by its terms, an offer may be accepted by any reasonable manner.

A party may accept an offer through a face to face conversation, or a party may accept an offer through formal written documents, such as a real estate purchase agreement.

Methods of Acceptance:

- i. **Oral Acceptance:** Absent a specified method of acceptance, an offer may be accepted orally.
- ii. **Written Acceptance:** Absent a specified method of acceptance, an offer may be accepted by writing.
- iii. **Mailbox Rule:** Where acceptance is properly submitted by mail, the law states that the acceptance becomes effective when it is deposited into a mailbox, and not when it is actually received by the offeror. Other forms of acceptance do not become binding on the offeror until they are actually received.

EXAMPLE: Mailbox Rule

Jane mails her written offer to Jerry. On day five, Jerry mails his acceptance to Jane. On day six, Jane calls Jerry and tells him that she is withdrawing the offer. Jane receives Jerry's acceptance on day seven. Despite the fact that Jane called Jerry and withdrew the offer before she received the acceptance, she is bound by the contract because the mailbox rule states that Jerry's acceptance was effective when he mailed it.

Counteroffer

A new offer by the offeree (intended recipient of an offer). By making a counteroffer, the initial offer is terminated by the offeree's rejection and replaced with a new offer. The offeree then becomes the offeror. The offeree and the offeror may switch positions throughout the negotiation process.

Offers Terminate as Follows:

Withdrawal: An offeror (the one making the offer) may withdraw his offer at any time prior to its acceptance by the offeree (the one receiving the offer) unless, for example, the offer is contained in a valid option contract. If the offeror withdraws the offer, the offeree no longer has the power to accept it and there can be no contract from the rejected offer.

Rejection: The offeree (intended recipient of an offer) terminates an offer by rejecting it (either explicitly or by making a counteroffer).

Death or Insanity: The death or insanity of either party prior to acceptance will terminate an offer. Acceptance of an offer and the subsequent formation of a contract require a “meeting of the minds”. A “meeting of the minds” occurs when both parties understand exactly what they have promised to do or not to do.

Both death and insanity prevent a meeting of the minds from occurring. Therefore, the death or insanity of either party terminates an offer that has NOT been accepted. However, once contracts arise, they survive the death of either party. In such cases, the estate of the deceased party is obligated to perform on behalf of the deceased.

Lapse of Time: Some offers terminate automatically if they are not accepted by a deadline established by the parties. Specifying a deadline for acceptance is one way to control an offer after it is communicated.

Legality of Object: Illegal contracts, if established, will result in a void contract—courts cannot be called upon to enforce contracts which require one to break the law.

EXAMPLE: Illegality

Contracts for murder or contracts to purchase illegal goods or services are void and unenforceable.

Fraud

Contract defense which consists of any form of deceit by which one party intentionally attempts to gain an unfair advantage over another. The key to determining whether an action is fraudulent is **whether or not it was intentional**. If the deceit was not intentional, it is not fraud, but may be an instance of misrepresentation.

Fraud includes intentionally making false statements and/or intentionally concealing material facts about real estate offered for sale. Fraud may result in damage awards by a court, and either a void or voidable contract depending upon whether it is fraud in the inducement or fraud in the factum.

Fraud in the Inducement: Intentional deceit (statement or concealment) about the nature of material facts or circumstances that causes one to enter into a contract. The resulting contract is voidable (seller misrepresents material information).

Fraud in the Factum: Intentional deceit (statement or concealment) that causes one to execute a document other than the document he intended to execute. The

resulting contract is void (no meeting of the minds; buyer tricked into signing document).

EXAMPLE: Fraud in the Factum

Sara Jones is contacted by a sales associate from the Heavenly Habitat subdivision and told that she has just won a two-bedroom house. Sara loves the house and when she is asked to sign a letter of endorsement for the subdivision, she does so gladly.

Later, Sara finds out that rather than actually winning a house, she has merely won a chance to win a house. Furthermore, the letter of endorsement she signed is actually a contract to buy a house if and when she fails to win one. Because Sara never intended to enter into a contract, and because she was intentionally deceived, the contract is void.

Misrepresentation (False Pretense)

A false statement or a concealment of a material fact that is unintentionally asserted. Unlike fraud, misrepresentations may be innocent and unintentional.

However, depending upon the circumstances and magnitude, even unintentional misrepresentation may be sufficient basis to render a contract void or voidable.

A primary consideration in determining the effect of a misrepresentation is a person's degree of knowledge, skill, and experience. Persons are held to various standards depending on their profession or experience.

EXAMPLE: Misrepresentation

Consider the statement: "This house is well built, and the foundation is solid." A year later, major foundation issues appear. Liability depends on who made the statement:

- *Seller – Likely not liable if the foundation appeared sound at the time; sellers aren't expected to have construction expertise.*
- *Sales associate – May be liable (and face discipline) if they knew or should have known about the defect.*
- *Builder – Likely liable for misrepresentation or even fraud due to their specialized knowledge.*

Estoppel

A legal doctrine that **allows a court to enforce a promise** even if a valid contract doesn't exist, in order to prevent unfairness. It applies when one party makes a promise, knows the other person will rely on it, and it would be unjust not to enforce it.

Reliance (Justifiable Reliance)

This is the key requirement for estoppel. It means the other party reasonably relied on the promise and took action (or didn't take action) because of it—resulting in some harm.

EXAMPLE: Reliance

Your employer tells you that he will pay a pension when you retire. Relying on this statement, you retire at an age where obtaining new employment is difficult because you are expecting that pension income. Even though there may be no consideration in this example (arguably, only the employer agreed to do something, which renders this a one-sided agreement), courts may enforce the agreement as a contract to prevent an inequitable result. Your reliance on your employer's promise put you in a worse situation.

Estoppel Certificate

Document, also known as certificate of no defense or estoppel letter, which clarifies the amount of debt owed by one party to another, and/or the legal status between parties as of a specified date.

Lenders use estoppel certificates to establish the mortgage amount owed as of a certain date. Landlords and tenants use estoppel certificates to establish the amount of rent owed (or not owed) as of a certain date.

All parties to a valid estoppel certificate are thereafter estopped (prevented) from claiming any position to the contrary.

Consideration

Consideration is a legal term that has a long history of interpretation and discourse in contract law. However, today it is understood to broadly exist where parties bargain with one another to exchange promises (usually involving money, as in real estate transactions).

Without consideration, there is merely a one-sided promise to act out of charity, and courts are reluctant to enforce such charitable promises.

Through the bargaining process, both parties agree, or promise, to do or not to do something like deliver goods in exchange for payment. The thing that both parties agree to do or not to do is the essence of consideration.

If a person promises to give away property without any consideration (gift promise), but later changes his mind, the one-sided promise could be unenforceable.

Once again, courts are reluctant to bind someone to perform a charitable act, even if they so promise.

EXAMPLE: Consideration

In a real estate transaction, the buyer makes an offer to buy property that the seller accepts. Dissecting this exchange of promises, we find consideration - the seller promises to do something (deliver the deed at a specified time to the buyer), and the buyer promises to do something (pay a specified sum of money for that deed). Conversely, if a seller merely promised to give his property as a gift, the seller's one-sided promise would lack consideration and could be unenforceable. This is true because there was no bargained for exchange of promises between the two parties, or no consideration (only the seller is promising to do something).

Classification of Contracts

Bilateral or Unilateral Contracts:

Unilateral Contract:

Contract where a single party promises to perform under specified conditions. Technically, the promise or obligation in a unilateral contract is only a unilateral offer because there is no meeting of the minds unless or until the second party decides to accept the offer by performing.

A common example of a unilateral contract is the promise to provide a reward in exchange for specified conduct (“\$50 reward for the return of my dog”).

EXAMPLE: Unilateral

Jon lost his dog. Jon posts a sign around town stating that he will pay \$100 to anyone who finds and returns his dog. Jon's offer may only be accepted by performance - that is, someone only has a contractual right to the \$100 after they find and return the dog.

Bilateral Contracts:

Contract where both parties make promises of performance. That is, one party makes a promise in terms of an offer, and the other party makes a promise in terms of an acceptance of that offer. The typical real estate sales contract is an example of a bilateral contract (promise to sell and promise to pay).

Express or Implied Contracts

Contract that contains terms or conditions that have not been expressly stated or written.

Implied contracts contain terms that may be inferred from the nature of a transaction or the conduct of parties. Implied terms in a contract can cause disputes because there is no express written agreement to regulate performance.

In the event of a dispute, courts may or may not rule that a term or condition is implied.

Executory or Executed Contracts

Contracts are executory where the parties reach an agreement, but have yet to perform (sales contract). Contracts are executed when they have been fulfilled (closing).

Conditions

Contracts may contain various conditions, or contingencies. A condition is an event which may not be certain to occur, but which must occur before performance under a contract is due. The presence of conditions is often indicated by words such as "if," "when," "unless," or "provided."

If a condition fails to occur, the parties are usually not entitled to damages because conditions are merely limitations—they do not create obligations.

A condition can be almost any event and may be left to either party to execute.

EXAMPLE: Conditions

Conditions that parties may impose include the following:

(1) A lessee may operate the leased premises as a restaurant, provided he first obtains the necessary parking variance.

(2) A buyer agrees to buy the property, contingent upon obtaining the necessary financing.

EXAMPLE: Conditions

A homeowner may condition payment for painting his house on his satisfaction with the paint job. Also, an insurance company may condition payment of a claim on the claimant furnishing proof of the loss. In these examples, there is a valid contract, but one or another party is not obligated to perform unless or until the condition or conditions are satisfied.

Formal or Informal Contracts

Formal Contracts

Formal contracts are agreements that must meet specific legal requirements to be enforceable, most commonly that they are in writing and signed.

In real estate, formal contracts are the standard because many agreements fall under the Statute of Frauds, requiring a written document. Examples include purchase and sale agreements, listing agreements, buyer brokerage agreements, and leases (typically over one year).

As long as all essential elements of a contract are present, these agreements are valid and enforceable, and they may also be signed electronically under laws such as UETA and the E-SIGN Act.

Informal Contracts

Informal contracts do not require a specific format and may be oral or written, provided all essential contract elements are present. While they can be legally valid and enforceable, they are less common and more risky in real estate because they are harder to prove and may not satisfy legal requirements.

Examples include a verbal agreement to rent property for less than one year or minor service agreements related to real estate.

However, if a contract is required by law to be in writing (such as most real estate transactions), an informal agreement will not be enforceable.

Progress Check - Contracts, Defenses and Fraud

1. Which of the following clarifies the amount of debt owed from one party to another?
 - A. Promissory note
 - B. Estoppel certificate
 - C. Reliance statement
 - D. Rescission document

2. The statute of frauds states:
 - A. There is a limited time to bring legal action to enforce a contract
 - B. A party to a contract has a pre-determined contract rescission period
 - C. Courts will not enforce oral contracts for the sale of land
 - D. Contract assignment requires an estoppel certificate

3. Which of the following is not a contract defense that would render the contract void or voidable?
 - A. Mistake
 - B. Duress
 - C. Incompetency
 - D. Sound mind

BREACH

Learning Objectives

- Explain legal and equitable remedies available for breach of contract.
- Distinguish between monetary damages, liquidated damages, and specific performance.
- Differentiate among common listing agreements and buyer-broker representation agreements.
- Explain when brokers earn compensation under ready, willing and able buyer and procuring cause principles.
- Distinguish between assignment and novation of contracts.
- Identify common events that terminate listing and buyer-broker agreements.
- Describe the nature of a real estate sales contract and the transfer of equitable title.
- Identify key clauses commonly found in sales contracts, including contingencies, default, notice, earnest money, prorations, title, and closing provisions.
- Explain the legal effect of clauses such as merger, survival, risk of loss, and time is of the essence.
- Identify who may sign closing documents through lawful authority such as power of attorney or estate representation.

Breach of Contract

Remedies for Breach

Breach of Contract. Circumstance where a party fails to perform as agreed in a contract without any recognized legal excuse. The non-breaching party may be entitled to an award of damages. Such an award may consist of either monetary damages—often in the form of liquidated damages—or specific performance (but not both).

Generally, the law does not allow punitive damages (damages imposed solely to punish the breaching party), or damages for “pain and suffering” (intangible harm) for breach of a contract.

Monetary Damages

A remedy for breach of contract that compensates the non-breaching party for financial loss. This may include:

- Benefit of the bargain damages: the difference between the contract price and the property's fair market value (FMV) at the time of breach (applies to either buyer or seller, depending on who breached), or
- Liquidated damages, if the contract specifies a pre-agreed amount.

Liquidated Damages: Damages that the parties agree in advance will be paid in the event of a breach. When a contract includes a liquidated damages clause and states it is the sole or exclusive remedy, the non-breaching party is typically limited to that amount and cannot pursue additional monetary damages or specific performance. In many real estate purchase agreements, liquidated damages are defined as the earnest money deposit or payments made under the contract.

EXAMPLE: Monetary Damages

A builder agrees to build a home for \$100,000, pursuant to a purchase agreement with a buyer. The buyer defaults before construction begins and there is no provision for liquidated damages in the contract. If the home would have cost the builder \$90,000 to construct, the builder's monetary damages would only be \$10,000 or the amount of profit he would have made from building the house.

Specific Performance

A court-ordered remedy that requires the breaching party to perform as promised under the contract (for example, to sell the property at the agreed price). Specific performance is commonly available in real estate sales contracts **because real property is considered unique**, and monetary damages may be inadequate.

However, specific performance is not available for personal service contracts, such as agency agreements, because courts will not force someone to perform personal services.

Assignment of Contracts

An assignment is the transfer of the contractual right, title, or interest of one person (“assignor”) to another (“assignee”). Some contracts may be assigned to another person and some may not (personal service).

Whether a contract is assignable depends on the subject of the contract and whether or not the parties, despite the subject, have specifically agreed to permit assignment. Other contracts may authorize or prohibit assignments (mortgages).

EXAMPLE: Assignable/Non-Assignable Contracts

Contracts for a personal service, such as a contract for a specific real estate broker to sell your property (listing agreement) are not assignable. However, most other real estate contracts, such as mortgage contracts, trust deeds, contracts for sale, lease contracts, and options are assignable, unless the parties agree otherwise in the contract.

Novation

A situation in which the parties to a contract agree to replace an existing contract with a new one, either by substituting a new obligation or replacing one of the parties. When a novation occurs, the original contract is fully terminated, and the new contract takes its place.

For a valid novation, all parties involved—including the party being replaced—must consent. Once the novation is complete, the original party is released from all liability, and the new party assumes the contractual obligations.

Contracts Important to Real Estate

Listing Agreement. A listing agreement is a special agency relationship between a seller (principal) and a broker (agent). The broker is the party to the contract with the seller and may authorize sales associates to act on the broker’s behalf to help carry out the listing. The broker’s authority is limited to the duties outlined in the agreement (special agency). In this relationship, the seller is the client, and buyers who are not represented by the broker are considered customers.

Common listing agreements include: Open Listing Agreements, Exclusive Listing Agreements, and Net Listing Agreements (illegal in most states).

Types of Listing Agreements

Open Listing

Agency agreement between a seller and any number of brokers, wherein the seller promises to compensate the broker if the broker sells the property. Under an open listing contract, the owner is only obligated to pay a commission to a broker if the broker successfully sells the property or was the procuring cause of the sale.

As an alternative, the owner may sell the property themselves and owe no commission to any broker.

The open listing contract may be oral or written, but it is unilateral (obligating only one party—the broker—to act), executory (will not arise unless or until a particular broker produces a buyer), and may have an indefinite expiration date.

However, many state laws impose an expiration date if one is not explicitly stated.

Exclusive Listing

An exclusive listing is a listing agreement between a seller and a single broker (the exclusive agent) which, for a limited time, provides the listing broker with rights to a commission if the property is sold.

Exclusive Agency:

A listing agreement where the seller agrees to pay the exclusive agent a commission if he or she sells the property, and if any other broker sells the property as well.

However, similar to the open listing agreement, the owner may sell the property himself and not be obligated to pay a commission to the broker.

Unlike open listing agreements, exclusive listing agreements must be written, are bilateral (obligating both parties), for a personal service (it cannot be assigned), and must have a definite expiration date.

Exclusive listing agreements are also executory (will not arise unless or until a particular broker produces a buyer).

Exclusive Right-to-Sell:

Similar to an exclusive agency, except that this listing agreement extends the greatest benefit (broadest opportunity for a commission) to the broker.

This is true because the seller/client agrees to list the property with a single broker (exclusive agent), and also agrees to pay that broker her commission regardless of who sells the property (another broker or even the seller himself).

An exclusive right-to-sell must be written, is bilateral, executory, for a personal service, and must have a definite expiration date.

Net Listing

Agency agreement between a seller and a real estate broker, whereby the seller/client hires the broker to locate a buyer and also agrees to compensate the broker with the difference between the actual sales price and some set amount of money.

Under a net listing agreement, the broker is free to sell the house for as much as he can get and keep all monies above an amount set by the owner.

Net listing agreements are illegal in most states (but not in Florida). Net listings include net sales agreements as well as net lease agreements.

EXAMPLE: Net Listing

An owner tells his real estate agent that he wants \$600 a month for the rental of an apartment he owns. The owner agrees to let the agent rent it for whatever he can get, keeping everything over \$600 as his commission. This arrangement is known as a net listing, which is illegal in most states.

Listing Agreements

Most state laws require real estate licensees to disclose the type of brokerage relationship (such as seller's agent, buyer's agent, dual agent, or non-agency) before or at the time of first substantive contact or before an agency relationship begins.

These disclosures must be clear, timely, and often in writing, so that consumers understand who the agent represents and what duties are owed. Failure to properly disclose can result in disciplinary action and loss of commission. When in doubt, disclose early and document it in writing.

Terminating Listing Agreements (FS 475.25(1)(r))

All listing agreements in Florida are required to have a definitive termination date.

A licensee may be disciplined by the Florida Real Estate Commission (FREC) for failing to include a definite expiration date in a listing agreement. An agent and seller should choose a mutually agreeable termination date, which they can always modify or extend by mutual assent.

Like any other agency agreement, in addition to full performance, listing agreements may terminate upon the following:

- abandonment by the broker (broker fails to take reasonable steps to sell the property)
- breach (a party fails to perform as promised)
- lapse of time (time specified in the listing agreement or state law lapses)
- mutual agreement
- revocation
- death, insanity, or bankruptcy
- change in ownership of the subject property
- destruction of the subject property

Canceling a Listing Agreement

If a seller decides to cancel a listing agreement such as an Exclusive Right of Sale Listing Agreement before its termination date, it is up to the broker to let the seller out of the agreement. There is no unilateral right to terminate the Exclusive Right of Sale Listing Agreement. If the broker agrees, the agent can use the Modification to Listing Agreement form.

The document offers two options, listed midway through the form:

- conditional termination
- unconditional termination

The listing broker and seller should carefully review the difference and select one of these options so they both understand what rights and obligations, if any, extend past the negotiated early termination.

Multiple Listing Service (MLS)

A Multiple Listing Service (MLS) is a cooperative database used by licensed brokers to share information about properties for sale. It allows listing brokers to market properties more broadly and enables other brokers to locate properties for their buyers.

A seller lists property with a listing broker, who has the primary agency relationship with the seller. With the seller's consent, the property is entered into the MLS.

While MLS data is widely distributed to public-facing websites, full MLS access is limited to licensed participants.

Listing Agreements (MLS Participation)

Properties entered into an MLS are typically listed under an exclusive right-to-sell agreement between the seller and the listing broker.

Historically, cooperating brokers were often treated as subagents of the seller, but today this is much less common. Instead, cooperating brokers typically represent their own clients (buyers) or act in another disclosed capacity, depending on the brokerage relationship.

Compensation

MLS participation does not guarantee or require commission sharing. Following recent industry changes, offers of compensation are no longer required to be made through the MLS. Compensation is now typically negotiated separately through:

- Listing agreements
- Buyer brokerage agreements
- Other written arrangements between the parties

A broker is only entitled to compensation if it is agreed to in a written agreement and they are the procuring cause of the transaction, where applicable.

Buyer Broker Agreements

A buyer-broker agreement (buyer agency agreement or buyer agency employment contract) is an agency relationship between a broker and a buyer, often including a sales associate working under the broker as a subagent.

Formal representation of the buyer creates an agency relationship between the buyer and broker, which also carries certain rights and responsibilities. Such formal representation contrasts with the informal assistance that a seller's agent may provide to a buyer without creating an agency relationship. Most states require that proper disclosure of this distinction be made to the buyer.

Just like the broker and seller, the nature of the relationship between buyer and broker should be established through a written agreement.

There are different types of buyer-broker agreements, but each should clearly specify:

- The services to be provided
- The responsibilities of the parties
- How, when, and by whom the broker will be compensated

In many states—and increasingly due to recent industry changes—buyer representation agreements are required to be in writing before providing brokerage services (such as showing property).

Legal Characteristics

A buyer-broker agreement is a bilateral, executory, personal service contract (and is generally not assignable without consent). While older rules sometimes allowed oral agreements, current practice and many state laws require written agreements.

Additionally, buyer-broker agreements must include a definite expiration date in most jurisdictions (especially where required by statute or regulation). If no expiration is stated, the agreement may be considered unenforceable rather than simply lasting a “reasonable time.”

Types of Buyer-Broker Agreements

Open Buyer Agreement

An open buyer agreement is the counterpart to an open listing. It's an agency relationship between a prospective buyer and a real estate broker which, like an open listing agency, permits any number of agents to be compensated depending on who first brings a suitable property to the buyer's attention.

In this case, the buyer is only obligated to compensate the broker who produces a property that the buyer actually purchases.

Exclusive Buyer Agreements

Exclusive buyer agencies usually appear in two types:

- the exclusive agency buyer agency
- the exclusive buyer agency

Exclusive Agency Buyer Agency Agreement:

An Exclusive Agency Buyer Agency is an agency relationship between a prospective buyer and a real estate broker where the buyer is only obligated to compensate the agent if the agent locates suitable property.

The buyer is not obligated to compensate the agent if the buyer finds suitable property on his own or through another agent. Exclusive agency buyer agency is the counterpart to the listing agreement known as the exclusive agency listing agreement.

Exclusive Buyer Agency Agreement:

An Exclusive Buyer Agency is an agency relationship between a prospective buyer and a real estate broker, which obligates the buyer to compensate the agent if the buyer purchases property similar to that described in the contract, regardless of whether the buyer discovers the property on her own or through another agent.

Exclusive buyer agency is the counterpart to the listing agreement known as the exclusive right-to-sell contract.

Termination of Buyer-Broker Agreements

Similar to the listing agreement, the buyer-broker agreement could be terminated under a number of circumstances short of full performance, including:

- abandonment by the broker (broker fails to take any steps to find suitable property for the buyer)
- breach

- lapse of time (time specified in agency agreement or by state law expires)
- mutual agreement
- death, insanity, or bankruptcy
- revocation

Compensation

Real estate agents (brokers) generally earn payment (commission) upon one of two events:

- when the agent (broker) produces a ready, willing, and able buyer
- when the agent (broker) is the procuring cause of any sale or purchase

Ready, Willing, and Able

A buyer who is prepared to meet the terms of the listing agreement, and has both the intent (willingness) and financial ability to complete the purchase. In many cases, a listing broker earns a commission by producing a ready, willing, and able buyer, even if the seller ultimately refuses to complete the transaction.

However, this depends on the terms of the listing agreement, as some agreements require a closed sale for the commission to be earned.

Procuring Cause

A broker earns a commission if they are the procuring cause of the sale, meaning they initiated a series of events that, without a break in continuity, resulted in the transaction. In disputes between brokers, procuring cause is used to determine which broker is entitled to the commission—not simply who first introduced the buyer.

Factors such as continuity of effort, abandonment, and participation in negotiations are considered.

Sales Contracts

Nature of the Purchase Agreement

Bilateral and executory contract, also known as a sales contract or a contract for sale, that specifies the terms and conditions of sale between a buyer and a seller of real estate.

Purchase agreements not only obligate a buyer to buy and a seller to sell, but also specify the terms, conditions, and procedures for closing. When only signed by the buyer, the purchase agreement is only referred to as an offer (offer to purchase). When signed by both parties, the offer to purchase becomes a purchase agreement.

Offer

The buyer begins the contracting process by making an offer. The seller then must determine whether to accept that offer and enter into a contract (purchase agreement) with the buyer. When only signed by the buyer, the purchase agreement is only an offer (offer to purchase).

Contract

When signed by both parties, the offer to purchase becomes a purchase agreement (sales contract, contract for sale), which specifies the terms of sale and closing, identifies the property, and provides equitable title to the buyer. Certain contract conditions, or contingencies, must be performed before contract performance is due.

Parties to the Purchase Agreement

The parties to a purchase agreement are the buyer and the seller, also known as the vendee and vendor. The vendee is the buyer and the vendor is the seller.

Contract Clauses

In addition to addressing matters such as identity of the parties, property description, purchase price, closing (settlement) date, identity of the settlement agent, and date of possession, a contract could also have one or more of the following clauses:

Assignment. The transfer of a party's contract rights or interest from one person (assignor) to another (assignee). Contracts are generally assignable unless prohibited by the contract. In real estate, sellers often restrict assignment or require written consent. Even when assignment is allowed, the original party may remain liable if the assignee fails to perform.

Contingency. A condition in a contract that must be satisfied before a party is obligated to perform, often identified by words like "if," "when," or "provided." If the contingency is not met, the contract is typically voidable by the party it protects.

Examples:

- *financing contingency*
- *inspection contingency*

Default. This provision sets forth the rights and obligations of the parties in the event that one party fails to perform. It lists the events that constitute default and may also address the remedies (specific performance, damages) available to the parties in the event of a default.

Liquidated Damages. Damages agreed to in advance by the parties to be paid in the event of a breach. In real estate, this is often the earnest money deposit. If the contract states liquidated damages are the exclusive remedy, the non-breaching party typically cannot pursue additional damages.

Notice. The parties to a contract must give each other notice of different events during executory period (title objections, results of inspection reports, whether the loan has been rejected or obtained, etc.).

The 3 types of notice are:

Actual Notice: When an individual searches public records, inspects the property, or is shown a legal instrument/document evidencing any of the above listed reasons for notice.

Constructive (Legal) Notice: When the public is charged with the responsibility to examine public records and to physically inspect the property in order to proactively discover the above listed reasons for notice.

Inquiry Notice: The law presumes notice when factors exist that would make a reasonable person to inquire further, whether or not a person actually does inquire further or discovers such information.

Property Condition. Most contracts provide that, at the closing date, the property will be in substantially the same condition as on the date the parties first signed the contract (normal wear and tear excepted).

Earnest Money. Purchase agreements may, but need not, include a pledge or deposit of earnest money. Earnest money is a cash deposit that commonly accompanies an offer to purchase.

It is evidence that the offeror intends in good faith to purchase the property, which may enhance the value of his offer. Subject to the parties' agreement, earnest money may be used as a down payment and/or as liquidated damages (remedy for the buyer's default).

Prorations. Any item that will be prorated (adjusted) between the parties at settlement date (property taxes, utilities, special assessments, HOA fees) should be set forth in a prorations clause.

Risk of Loss. This clause usually provides that the seller bears the risk of loss due to fire or other casualty that occurs during the executory period of the contract.

Survival / Merger. At closing, most contract terms are merged into the deed and do not survive. This means that once a buyer accepts the property at settlement, they generally cannot later enforce contract promises that were not fulfilled. However, parties can include a survival clause to ensure certain obligations continue after closing.

Time is of the Essence

As a general rule, time limits in contracts imply "reasonable time" and are not strictly enforceable.

Example: A closing date that is set for July 15 means July 15, or a reasonable time thereafter.

Most parties prefer the dates in a real estate contract to be enforced strictly so they include a "time is of the essence" provision. This phrase may appear in a contract, and means that the parties have agreed on a definite time for performance.

A party will breach the contract unless performance is rendered by the exact time specified.

Example:

If the parties specify a closing date and time as "November 3, 2009, at 12:00pm," and further specify that "time is of the essence," then a party who arrives to the closing at 12:05pm is in breach of the sales contract.

Title

When a purchase agreement is signed, the buyer receives equitable title (the right to obtain ownership), while the seller retains legal title until closing.

At closing, legal title transfers to the buyer.

The title provision outlines the quality of title the seller must deliver (such as marketable or insurable title), the type of ownership interest (typically fee simple), and any warranties made in the deed. It also typically allows the seller time to correct title defects discovered during the buyer's title search.

If defects cannot be corrected, the contract is usually voidable by the buyer. Buyers generally agree to accept standard easements and recorded restrictions.

Closing

Point in time when the seller tenders title to the buyer or a neutral third person in exchange for the buyer's payment of the purchase price. Florida does not have a law mandating that a real estate closing take place in the county where the real property is located.

However, many sale/purchase form contracts include pre-printed provisions indicating where the closing must take place. If parties don't close on the closing date, the contract still exists. The issue then becomes why the contract failed to close and whether either (or both) parties breached the agreement.

Authorization to Sign Closing Documents

A seller may issue a power of attorney authorizing someone else to sign closing documents. Florida law allows a power of attorney to be used in Florida real estate transactions. This document should state the specific powers the seller is granting to the attorney-in-fact and should comply with Florida law.

In the case of a deceased person, the personal representative assigned during probate has the authority to sign documents and make decisions concerning the disposition of the estate. It is important to know that a power of attorney (even a durable one) cannot survive the death of the principal.

Addenda

An addenda to a contract are extra items that need to be addressed that may not be mentioned in the main body of the contract.

Addenda items are binding and need to be completed just like the main parts of the contract. Some items typically in an addenda are:

- seller's property condition disclosure
- radon or other hazardous material disclosures
- agency disclosure
- flood plain disclosure (if applicable)

Progress Check - Breach & Contracts Specific to Real Estate

1. Marty died while he was party to an executory property sales contract, since Marty's estate must honor the contract who is allowed to sign at closing?

- A. Marty's personal representative
- B. Marty's next of kin
- C. Marty's real estate agent
- D. No one, the contract must be re-written

2. Regarding monetary damages stemming from breach of contract, "benefit of the bargain" means:

- A. The difference between contract price and market cost
- B. The difference between contract price and appraised value
- C. The difference between contract price and fair market value
- D. The difference between contract price and assessed value

3. One thing all types of Florida listing agreements must have is:

- A. Notarized signatures
- B. An MLS ID number
- C. A rescission clause
- D. An expiration date

Module 3.1 Developing Business Plans

Learning Objectives

- Explain the purpose and practical use of mission and vision statements in a brokerage.
- Differentiate between traditional and lean startup business plan formats and identify when each is most appropriate.
- Identify the major components of a real estate brokerage business plan.
- Describe marketing plan elements including market research, target market selection, positioning, branding, and performance measurement.
- Understand the broker's role in leadership, supervision, and organizational structure.
- Recognize the importance of policies, procedures, and compliance systems within a brokerage.
- Identify technology tools commonly used to operate a modern real estate brokerage.
- Explain the role of budgeting, revenue planning, and financing in launching or operating a brokerage.
- Compare common business entity structures and liability considerations for brokerage ownership.
- Evaluate office location models such as traditional, home office, hybrid, and virtual operations.

PLANS SPECIFIC TO A REAL ESTATE BROKERAGE

Opening a Brokerage

The transition from agent to owner can be daunting unless you have a solid business plan to help guide you through the process.

Creating a business plan helps detail the foundation and goals you have for your business. There are a variety of brokerage business models to choose from including one based on full commission, flat fees, individual service fees or traditional. No matter which format is chosen for the brokerage, the business plan should include a mission and vision statement, budget, marketing plans, a proposed management structure and policies for employees/personnel.

The best way to begin a business plan for a real estate brokerage is to craft clear mission and vision statements. These foundational statements define not only what the brokerage does, but also where it is headed, serving as a roadmap for all future decisions.

A mission statement focuses on the present—it defines the brokerage’s purpose, the clients it serves, and how it delivers value in day-to-day operations. It answers the question: “What do we do, and for whom?” In a real estate context, this may include a commitment to ethical service, market expertise, or a specific niche such as residential, commercial, or property management.

A vision statement, on the other hand, looks to the future. It outlines the brokerage’s long-term goals and what it aspires to become within the industry or community. It answers the question: “Where are we going?” A strong vision may focus on growth, reputation, innovation, or developing top-performing agents.

This process may be completed individually by the owner or collaboratively as a team effort involving affiliated licensees and staff. Involving others can help create alignment and buy-in across the brokerage. Brainstorming sessions are especially effective, allowing participants to generate a wide range of ideas, evaluate priorities, and refine them into clear, focused goals that reflect the brokerage’s values and direction.

Well-crafted mission and vision statements provide more than just words on paper—they guide recruiting, training, supervision, marketing, and overall brokerage operations. Without them, a brokerage may lack consistency and strategic direction; with them, the firm operates with purpose and cohesion.

Mission and Vision Statements

While drafting mission and vision statements some things to consider might include:

- ✓ Is there a particular type of real estate your brokerage will focus on (residential, commercial, industrial etc.)?
- ✓ Where will your brokerage office be located (this might affect the amount of marketing required)?
- ✓ What type of business entity will your brokerage be (partnership, sole proprietorship, corporation, etc.)?
- ✓ What functions of your brokerage will provide an edge on the competitors?
- ✓ What are the values the brokerage will follow?

Vision Statements

A well written vision statement will clarify your business's meaning and purpose to those within the brokerage as well as clients and customers outside the brokerage. Vision statements help ensure everyone involved with the brokerage, especially the employees, are focusing their efforts toward a common goal. The brokerage's desired long-term results related to the company's efforts are detailed within the vision statement.

The brokerage vision statement does not have to be lengthy, actually a concise statement the entire organization is able to repeat quickly and understand is preferred. Using a timeline may help in drafting a vision statement; where should the brokerage business be in one year or five years. Finally, ensure the goals are specific and enthusiastic but also achievable.

Vision Statement Examples:

Amazon: "Our vision is to be earth's most customer-centric company; to build a place where people can come to find and discover anything they might want to buy online."

IKEA: "To create a better everyday life for the many people."

Google: "To organize the world's information and make it universally accessible and useful."

Samsung: "To inspire the world and shape the future through innovative technologies."

Real Estate Example: “Our vision is to become the most trusted and recognized real estate brokerage in our region, known for exceptional client experiences, strong community relationships, and consistent agent success.”

Mission Statements

Mission statements help guide day-to-day decision-making and play a key role in creating consistency across the brokerage, particularly in areas such as client service, marketing, and supervision.

When clearly defined, the mission helps brokers train and supervise licensees more effectively by setting expectations for conduct, communication, and performance. This is especially important in maintaining compliance, reducing risk, and delivering a consistent client experience across all transactions.

Mission Statement Examples:

Nike: “To bring inspiration and innovation to every athlete in the world.” (If you have a body, you are an athlete.)

Tesla, Inc.: “To accelerate the world’s transition to sustainable energy.”

Walmart: “To save people money so they can live better.”

Microsoft: “To empower every person and every organization on the planet to achieve more.”

Real Estate Example: “To provide knowledgeable, ethical, and results-driven real estate services that help clients confidently buy, sell, and invest in property.”

Types of Business Plans

The most important factor in developing a business plan is that it meets the specific needs of the brokerage. Business plans are not “one-size-fits-all” and should be tailored to the size, goals, and stage of the business. Most business plans generally fall into two common categories: traditional and lean startup.

The traditional business plan is the most comprehensive format. It follows a structured outline with detailed sections such as market analysis, organizational structure, services, marketing strategies, and financial projections. Because of its depth, this type of plan is typically longer and more time-intensive to prepare, but it is often required when seeking financing or outside investment.

A lean startup business plan is a more streamlined approach that focuses on summarizing the key elements of the business. Instead of extensive detail, it highlights essential components such as value proposition, target market, revenue streams, and competitive advantage. This format is shorter, more flexible, and easier to update, making it well-suited for brokerages that are just starting out or adapting to changing market conditions.

Traditional Business Plan

A traditional business plan typically includes the following elements:

1. Executive Summary – A high-level overview of the brokerage and its goals
2. Company Description – Details about the brokerage, including its structure, services, and market position
3. Market Analysis – Research on the target market, competition, and industry trends
4. Organization and Management – The brokerage’s ownership structure and management team
5. Service or Product Line – Description of real estate services offered (e.g., residential sales, property management, commercial services)
6. Marketing and Sales Strategy – How the brokerage will attract and retain clients
7. Funding Request (if applicable) – Amount of funding needed and how it will be used
8. Financial Projections – Forecasted income, expenses, and profitability
9. Appendix – Supporting documents such as resumes, licenses, or additional data

Lean Startup Plan

A lean startup plan typically includes the following elements:

1. Key Partnerships – Strategic relationships that support the brokerage (e.g., lenders, title companies, vendors)
2. Key Activities – The most important actions the brokerage performs (e.g., listing, marketing, client management)
3. Key Resources – Essential assets such as agents, technology, brand, and office space
4. Value Proposition – What makes the brokerage unique and valuable to clients
5. Customer Relationships – How the brokerage interacts with and retains clients
6. Customer Segments – The target market (e.g., buyers, sellers, investors, luxury clients)
7. Channels – How the brokerage reaches clients (e.g., online marketing, referrals, MLS, social media)
8. Cost Structure – Major expenses involved in running the brokerage
9. Revenue Streams – How the brokerage generates income (e.g., commissions, fees, property management income)

Traditional vs. Lean Startup Business Plan

Feature	Traditional Business Plan	Lean Startup Business Plan
Purpose	Detailed planning and securing financing	Quick planning and flexibility
Level of Detail	Comprehensive and in-depth	High-level and summarized
Length	Longer (multiple sections/pages)	Short (often 1–2 pages)
Time to Create	Time-intensive	Faster to develop
Best Used When	Seeking loans, investors, or long-term planning	Starting out, testing ideas, or adapting strategy

Developing The Team

A successful real estate sales agent does not necessarily always possess the skills needed to be a good manager or leader. As a leader you will need to provide the agents attached to the brokerage the tools they need to succeed individually which will in turn help the brokerage succeed.

Your team's success will depend as much as anything on the systems and processes you put in place — marketing systems, lead generation systems, systems for tracking progress and measuring success, processes for following up with leads, processes for launching new listings, and on, and on, and on. These systems will help provide accuracy, consistency and tracking to all brokerage transactions.

A happy team definitely aids in the success of the brokerage. In order to ensure the cooperation of all colleagues, supervisors, and agents involved in your plan consider the following:

- Is your business plan's success contingent upon the cooperation of your colleagues?
- What specifically do you need the agents to do to fulfill the brokerage business plan?
- How will you evaluate agent/employee participation?
- Will you discuss each agent's role with them individually and ensure they have a clear purpose?
- How will you get “buy in” from all agents/employees?

Marketing

Another part of a solid business plan is the brokerage marketing which will cover identifying your market, attracting prospects, converting prospects into customers, and retaining customers.

Marketing is typically done on two levels, **strategic and tactical**. Strategic to identify the overall market and tactical to execute on the marketing plan. In the end the marketing plan should help your firm set goals, implement strategies, and measure results.

Situational Analysis / Market Research:

- Assess market trends - Is the market affected by seasons or other factors?
- Profile your ideal customer (demographics, size, location, needs, industry, etc.).
- Determine what current product sales are.
- Identify potential vendors and calculate the costs of buying their supplies.
- Describe strengths, weaknesses, opportunities, and threats your business faces (SWOT Analysis).

Target Market: Identify and understand your market niche.

Positioning: Identify how you want your customer to think about you.

Product:

- Describe your product or service, its uses, who uses it, who needs it, and what is currently used if they don't use your product.
- Define your value proposition.

Marketing Strategies and Methods:

- ✓ Create your messaging, including taglines, product descriptions, and call to action plan.
- ✓ Promoting your product: Networking, advertising, social networking sites, web site, phone calls, email blasts, etc.
- ✓ Consider creating brochures, flyers, press releases, or other printed material.
- ✓ Decide if and how you will utilize sales people (internal or contract).
- ✓ Create brand awareness by promoting your product and distinguishing it from competitors.

Marketing Goals:

Determine how many prospects you will contact daily, weekly, and monthly.
Commit to attending networking functions.

Monitor Results:

Define measurements for your marketing strategies.

Track sales, leads, visitors to your web site, percent of sales to impressions, etc.

Implementing the Business Plan

Two of the most vital aspects of a business plan are implementation and follow-up. It is best to schedule calendar reminders to review the business plans goals on a regular basis (annually, semi-annually, quarterly, or monthly). Consider the following while reviewing:

- ✓ Are you on track?
- ✓ Are the goals reasonable to achieve, impossible, or too easy?
- ✓ Is the method of measuring success (revenue, profit, or number of transactions) effective?

Brokerage Responsibility/Liability

Are you qualified to run a real estate business? Most states will require one person in the brokerage to be a licensed real estate broker. The licensed broker will be responsible for all real estate transactions within the brokerage and can be held liable for the actions of the agents working for them.

In this stage of starting a real estate brokerage, you will actually begin sketching your company on paper. It's also the perfect time to run through the potential problems that may arise.

Branding the Brokerage

After determining the type of brokerage business you want to form, you need to establish a name, or brand. This will be how people will identify with your brokerage and can help with aspects of assembling the business plan as well as securing a loan eventually.

Many people use part of their name within the business brand, which makes it unique and more likely the name isn't already being used. Once you have the business brand, get it out to the public by securing a domain name and social media handles.

Business Location

"Location," "Location," "Location"—where do you plan to establish the brokerage? There are main offices, branch offices, and home offices. Most states require **at least one registered main office**, while additional offices are optional depending on the size and structure of the brokerage.

Some brokerages operate using a virtual or remote business model to reduce overhead costs; however, in many states, including Florida, brokers are still required to maintain a physical office location that complies with state law. A fully virtual brokerage with no physical office may not be permitted.

A hybrid approach is a common and practical option. In this model, the brokerage maintains a small physical office to meet legal requirements and conduct in-person meetings when needed, while also leveraging virtual tools to communicate with clients and manage transactions efficiently.

Technology

In today's real estate environment, technology is essential for operating an efficient and competitive brokerage. High-speed computers and reliable internet access remain foundational, along with access to the MLS for property searches, listing management, and market data. Brokerages also rely on customer relationship management (CRM) systems to organize contacts, automate outreach, and manage follow-up with clients and prospects.

Modern brokerages use a wide range of tools to streamline operations, improve client service, and support affiliated licensees. These include:

Transaction Management Platforms – Systems that manage contracts, disclosures, and compliance from contract to closing.

Electronic Signature Tools – Allow clients to sign documents remotely, improving speed and convenience.

Cloud-Based Storage – Secure storage and sharing of transaction files and brokerage records.

Marketing and Social Media Tools – Digital advertising, email campaigns, and social platforms used to generate leads and build brand presence.

Virtual Meeting Platforms – Tools that allow brokers and agents to meet with clients remotely when in-person meetings are not practical.

Voice-over-Internet-Protocol (VoIP) systems are also widely used and allow brokers and agents to manage calls efficiently through internet-based phone systems. These systems often provide features such as call routing, multiple lines, voicemail transcription, and mobile integration, making them useful for both traditional and hybrid brokerage models.

The Management Structure

Management of a real estate brokerage is a critical component of its overall success. There are various management styles, ranging from highly hands-on (micromanagement) to more hands-off (*laissez-faire*), with most effective brokerages operating somewhere in between. The ideal approach provides appropriate oversight and supervision, while still allowing affiliated licensees the autonomy needed to effectively serve their clients.

Brokers must strike a balance between independence and accountability, particularly because they are legally responsible for the actions of their licensees. This makes supervision, training, and clear communication essential elements of the brokerage's management structure.

When considering whether the brokerage will operate from a traditional office, a home office, or a hybrid model, it is important to recognize that remote or virtual operations can present additional supervision challenges. Brokers must ensure they have systems in place—such as regular check-ins, transaction reviews, and technology platforms—to maintain compliance and oversight, regardless of physical location.

Including an organizational chart in the business plan can be extremely helpful. This chart should clearly define roles, responsibilities, and reporting structure within the brokerage, helping to ensure accountability, efficiency, and effective management.

Policy and Procedures

Employees need—and most thrive with—**clear guidance**. To promote consistency and reduce confusion, a brokerage should develop a comprehensive policy and procedures manual that outlines expectations and provides detailed instructions for the real estate transactions and activities licensees will be involved in.

A well-written manual helps standardize processes such as contract handling, advertising, escrow procedures, client communication, and compliance requirements. This is especially important because brokers are **legally responsible** for supervising their licensees and ensuring that all activities are conducted in accordance with applicable laws and regulations.

As a best practice, the policy and procedures manual should be reviewed with each employee or affiliated licensee, and each individual should be provided with a copy for ongoing reference. Regular updates and training should also be conducted to reflect changes in laws, regulations, and brokerage practices.

Structure and consistency are critical—even for routine tasks such as office procedures or purchasing supplies. Clear policies help create efficiency, reduce risk, and support a professional and compliant brokerage environment.

Budget

Although an exact budget may be difficult to finalize during the business planning phase, a reasonable budget estimate should be included in the brokerage's business plan. This estimate helps the broker project startup costs, ongoing expenses, and expected revenue, all of which are critical to determining the financial feasibility of the business.

Developing a budget can also help the broker estimate how many agents the brokerage can realistically support, as well as how many agents or transactions may be required to meet profitability goals. Key expenses may include office space, technology, marketing, licensing, insurance, and administrative support.

Financing the Brokerage

Financing a real estate brokerage can sometimes be more challenging than financing other types of businesses because brokerages often have limited tangible assets to use as collateral. As a result, lenders may require the broker/owner to provide personal guarantees or collateral, increasing the financial risk to the individual.

Brokers may explore several financing options, including:

- Traditional bank loans
- Small Business Administration (SBA) loans (which are partially guaranteed by the government but still issued through lenders)
- Personal funds or savings

- Private funding from family or investors
- Retirement fund rollovers (ROBS), which may allow the use of retirement funds (such as a 401(k)) without early withdrawal penalties if structured properly

Business Entity

If you have partners, it is essential to clearly define revenue sharing, roles, responsibilities, and decision-making authority in a written agreement. The extent of each partner's liability will depend on the chosen business structure. For example, in a general partnership, partners may be jointly and severally liable for the obligations of the business, while in entities such as limited liability companies (LLCs) or corporations, owners typically have limited liability protection.

Choosing the appropriate business structure is a critical decision when forming a brokerage. A limited liability company (LLC) is a common choice because it can provide liability protection while allowing operational flexibility. However, no single structure is "best" for every situation. Brokers should consult with a qualified attorney and/or accountant to determine the most appropriate entity based on their specific business goals, tax considerations, and risk tolerance.

Progress Check - Plans Specific to a Real Estate Brokerage

1. Marketing a new business includes all of the following except:
 - A. Attracting prospects
 - B. Identifying the market
 - C. Risk assessment
 - D. Converting prospects into customers
2. A _____ details where an organization aspires to go.
 - A. Mission statement
 - B. Business plan
 - C. Marketing strategy
 - D. Vision statement

3. Which business structure is most common for a new real estate brokerage?

- A. A sole corporation
- B. A cooperative
- C. A limited liability company
- D. A joint venture

Module 4 - Time Management

Learning Objectives

- Apply practical time management strategies to improve productivity and organization.
- Identify and implement time management techniques relevant to real estate practice.
- Explain how clear goals and daily activity planning improve results.
- Understand prioritization models such as the 80/20 Rule and Eisenhower Method to focus on high-value tasks.
- Apply the 4Ds framework (Do, Defer, Delegate, Delete) when managing tasks.
- Be familiar with time blocking, scheduling, and deadline systems to improve efficiency.
- Recognize how technology tools such as CRMs, automation, and electronic signatures create leverage.
- Understand the role of boundaries, breaks, and work-life balance in sustained performance.
- Identify productive ways to use short periods of downtime during the workday.
- Recognize the broker's role in helping agents stay focused on productive, income-generating activities.

TIME MANAGEMENT STRATEGIES & TIPS

As a real estate agent, you may work as either an hourly employee or, more commonly, an independent contractor, both of which require strong time management skills. For agents with set working hours, time management is partially structured by the brokerage, providing a defined framework for scheduling daily tasks and responsibilities. In contrast, independent contractor agents are responsible for creating and maintaining their own schedules. This requires a higher level of discipline, organization, and accountability, as there are typically no fixed hours or direct supervision guiding daily activities.

Regardless of the work structure, real estate is a client-driven business. There will always be situations where client needs arise outside of planned working hours. Successful agents must be able to prioritize tasks, remain flexible, and adapt their schedules to meet these demands while still maintaining productivity and work-life balance.

Time Management Strategies

Once working hours are established—whether by the brokerage or the agent—the next step is determining which tasks need to be completed within that time frame. Some tasks will occur daily, such as responding to emails, managing client communications, and completing required reports. Other tasks may arise unpredictably, such as new client inquiries, contract negotiations, or urgent issues that require immediate attention. Time should be intentionally reserved within the schedule to accommodate these unexpected demands.

Time Management Strategies

One effective method of organizing tasks is to prioritize activities based on urgency and importance. Agents may choose to complete high-priority or time-sensitive tasks early in the day, while scheduling less urgent tasks for later.

For example, responding to client communications is typically time-sensitive and should be addressed promptly, while administrative tasks or reports may be scheduled during less demanding periods of the day.

It is important, however, to avoid becoming overly reactive—such as spending the entire day responding to emails. Instead, agents should balance responsiveness with productivity by setting priorities and maintaining control of their schedule. The key is to organize tasks in priority order while allowing flexibility for client needs and unexpected situations.

Setting clear activity goals is essential for staying on track and achieving results. Start with a larger goal, then break it down into specific, actionable steps.

For example, if your goal is to get two properties under contract each week, identify the activities needed to make that happen—such as sending marketing emails, posting on social media, or distributing mailers.

By breaking larger goals into daily tasks, you create a manageable plan. Completing small, consistent actions each day helps drive results and keeps you focused on high-impact activities rather than wasting time on less productive ones.

Leverage

It has never been easier for real estate agents to “work smart” by leveraging technology and systems to improve efficiency and time management.

For example, agents can use a customer relationship management (CRM) system to automate follow-up with past clients and prospects. These platforms often include tools such as email automation, calendar reminders, and client databases for tracking interactions and opportunities.

By leveraging these tools, agents can stay organized, maintain consistent communication, and focus more time on high-value activities such as lead generation and client service.

Agents can also leverage tools such as video conferencing platforms, electronic signature software, virtual tours for listings, and social media marketing to streamline communication and enhance client service.

When used effectively, these tools allow agents to better allocate their time to tasks that cannot be automated—such as building relationships, negotiating contracts, and providing personalized client guidance.

Leveraging available technology helps free up valuable time that would otherwise be spent on administrative or logistical tasks.

Because real estate involves a wide variety of responsibilities—including communication, transaction management, and follow-up—using time efficiently is essential to long-term success.

Work hard, Play Hard

An important aspect of time management is making time to enjoy life outside of work. Real estate can be fast-paced and task-heavy, so it is essential to avoid becoming overwhelmed by intentionally scheduling time away from work.

When it is time to work, stay focused and make that time productive. Equally important is blocking off dedicated time for family, personal interests, and rest. Building time for recreation and personal development helps reduce stress, prevent burnout, and maintain long-term productivity.

Agents should also recognize their limits. Taking on more clients than can be effectively managed can lead to decreased service quality and increased stress. Focusing on what can be handled well allows agents to provide better service while maintaining a healthy work-life balance.

Time Management = Task Management

There are many approaches to time management, but they share a common principle—time management is really about how you manage your tasks and priorities.

Effective time management is not about working faster, cutting hours, or finding shortcuts. Instead, it focuses on how you spend your time, what you prioritize, and where you direct your attention.

The 80/20 Rule (Pareto Principle)

The 80/20 Rule, also known as the Pareto Principle, was developed by economist Vilfredo Pareto in the late 19th century. It suggests that approximately 80% of results come from 20% of efforts.

In real estate, this often means that a small portion of your activities—such as lead generation, client follow-up, and negotiations—produce the majority of your results.

The key takeaway is to focus on high-impact activities and reduce time spent on tasks that do not directly contribute to your goals. Lower-value tasks should be delegated, scheduled, or eliminated whenever possible.

The Eisenhower Method

One practical way to apply the 80/20 Rule is through the Eisenhower Method, a time management strategy often associated with Dwight D. Eisenhower and later popularized in *The 7 Habits of Highly Effective People* by Stephen Covey.

This method organizes tasks into four categories:

- **Important and Urgent** – Do these tasks immediately
- **Important but Not Urgent** – Schedule these tasks
- **Urgent but Not Important** – Delegate if possible
- **Not Important and Not Urgent** – Eliminate or minimize

Time Management Tip #1 - Goals - Small and Achievable

“Succeeding as a real estate agent” is a goal that is too broad to accomplish on a daily basis. While it can serve as a long-term objective, success is achieved by setting small, specific, and actionable goals that can be worked on daily and weekly.

Since commission is often a primary measure of success in real estate, it can be used as a benchmark to create these smaller goals.

For example, if your goal is to earn \$60,000 in commissions in one month, you can break that down by asking:

How many transactions do I need to close?

How many clients or listings do I currently have?

How many additional clients do I need?

Prioritization, Flexibility, and Systems: Even the best plans can be disrupted in a real estate environment. Client demands, contract deadlines, inspections, and negotiations often require immediate attention. While prioritization is important, successful brokerages rely on structured systems and processes to manage these interruptions effectively.

Brokers should implement systems that help agents stay organized and responsive, such as:

- ✓ Transaction management platforms to track deadlines and documents
- ✓ Shared calendars for key dates (closings, inspections, contingencies)
- ✓ Standardized workflows and checklists to ensure consistency

Flexibility remains essential, but it should be supported by structure. Agents must be able to adjust their schedules as needed while still maintaining focus on high-priority activities.

From a management perspective, brokers should also monitor how agents are spending their time and provide guidance to ensure efforts are focused on productive, income-generating activities, rather than low-impact tasks.

Time Management Tip #2 – Determine What to Do with Tasks

Another effective time management system is the 4Ds of time management, which aligns with the 80/20 rule by helping agents quickly decide how to handle tasks. This method breaks tasks into four categories:

- **Do** – Complete the task immediately if it is important and requires your direct attention
- **Defer** – Schedule the task for a later time if it is important but not urgent
- **Delegate** – Assign the task to someone else (such as an assistant or transaction coordinator) if it does not require your direct involvement
- **Delete** – Eliminate the task if it does not add value or contribute to your goals

Using the 4Ds helps agents focus on high-impact activities, reduce distractions, and make better use of their time throughout the day.

For example, negotiating a contract = Do, updating a database = Delegate, posting on social media = Defer, unnecessary meetings = Delete.

Time Management Tip #3 - Distraction Free Time

Frequently switching between tasks can reduce focus and lead to lost productivity. One effective strategy is time blocking, where specific periods of the day are set aside for particular tasks.

For example, an agent may dedicate a block of time for prospecting, client follow-up, or administrative work. Setting aside time at the end of the day for follow-up calls can also help identify priorities for the next day.

Equally important is protecting these time blocks from interruptions. During focused work periods, agents should minimize distractions by limiting phone notifications, avoiding unnecessary interruptions, and working in a quiet environment. This allows for more efficient use of time and improved task completion.

While timely communication—such as responding to emails—is important, agents should avoid becoming overly reactive. Instead, email and message responses can be handled during scheduled times throughout the day to maintain both responsiveness and productivity.

Maintaining a distraction-free workspace is also essential for protecting client confidentiality while completing tasks efficiently.

Time Management Tip #4 – Set deadlines and schedules

Setting deadlines gives you a defined timeframe to complete a task, which helps improve focus and productivity. Deadlines can also serve as a tool to evaluate your time management and improve how you organize tasks and projects.

Developing an accurate understanding of how long tasks take requires time and experience. However, tracking task completion times and using that information to set realistic deadlines and schedules can significantly improve efficiency.

By monitoring how long it takes to complete various activities—such as client follow-up, contract preparation, or marketing—you can build better time awareness and create a more streamlined and effective schedule.

Time Management Tip #5 – Saying "No"

When building a clientele and brand, it can be difficult to turn down requests or limit meetings, phone calls, and other interactions. However, setting boundaries is sometimes necessary to maintain productivity and provide quality service.

Agents must recognize that they have limited time and capacity. Taking on too many tasks or clients can lead to being spread too thin, resulting in decreased service quality and increased stress.

Focusing on what can be managed effectively allows agents to deliver a higher level of service to their clients. In many cases, providing excellent service to fewer clients is more beneficial than providing mediocre service to many.

Time Management Tip #6 – Take Breaks

While it is important to schedule time away from work, incorporating short breaks throughout the day is equally valuable for managing stress and maintaining productivity. Taking time to recharge helps improve focus, efficiency, and overall performance.

Agents should determine what break schedule works best for them—for example, a 5-minute break each hour or a 15-minute break every 2–3 hours—and remain consistent. Setting reminders can help ensure breaks are not skipped during busy periods.

Simple activities such as walking around the office, stepping outside for fresh air, or grabbing a drink or snack can help reset focus and prevent burnout.

Making Use of Small Time Blocks

There may be times throughout the day—although often brief—when you have small periods of downtime. This could occur while waiting for a return call, during a showing while a client is viewing a property, or between appointments.

Using these short time blocks effectively can help you stay productive and get ahead on important tasks. Rather than letting this time go unused, focus on completing quick, meaningful activities such as:

- Calling a potential client
- Reviewing or updating your to-do list
- Sending a note or follow-up message to a past client
- Completing or organizing paperwork
- Preparing for an upcoming listing appointment
- Drafting content for a newsletter or marketing campaign
- Reviewing a contract before presenting it to a client
- Updating your contact database (CRM)
- Practicing brief stress-reduction techniques

Progress Check - Time Management

1. The 80/20 time management rule states:
 - A. 80% of tasks are important and 20% are not
 - B. 80% of results come from 20% effort
 - C. It takes 80% effort to complete 20% of tasks
 - D. With good time management 80% of tasks can be accomplished in 20% less time
2. Which of the following examples would be considered leverage?
 - A. Gaining 5% more clients by word of mouth
 - B. Being able to charge a higher commission percentage due to location change
 - C. Using technology to be more efficient and effective when completing tasks
 - D. Allocating a maximum amount of time per client to allow for increased client base
3. Which of the following is not one of the 4Ds of time management?
 - A. Do
 - B. Delegate
 - C. Delete
 - D. Divert

Module 5 - Real Estate Finance

Learning Objectives

- Differentiate between lien theory and title theory states and their effect on ownership and foreclosure.
- Distinguish between promissory notes, mortgages, and deeds of trust.
- Explain assignment, novation, and reduction (estoppel) certificates in mortgage transactions.
- Differentiate between mortgage assumption and taking title subject to existing financing.
- Explain hypothecation and the release of liens through satisfaction or reconveyance.
- Describe lien priority, junior liens, and the purpose of subordination agreements.
- Differentiate among common mortgage types, including fixed-rate, adjustable-rate, purchase money, blanket, wraparound, and open-end mortgages.
- Explain amortization concepts including fully amortized, partially amortized, balloon, and negative amortization loans.
- Identify key ARM features such as indexes, margins, teaser rates, and interest-rate caps.
- Recognize equity-based lending products such as home equity loans, HELOCs, and reverse mortgages (HECMs).

MORTGAGE LAW & TYPES OF MORTGAGES

Financing

Financing is the process by which a buyer purchases property without paying the entire purchase price in cash. Financing typically involves a financial institution that lends the borrower the funds needed to buy the property, minus any down payment.

Lenders assume risk when providing financing for real estate. However, there are a variety of lending procedures and criteria used to minimize the risk that a borrower will default on a loan. These include the borrower's pledge of collateral, the lender's qualification of the borrower, and the lender's control of loan-to-value (LTV) ratios. Lenders are compensated for assuming this risk through interest, which is assessed on the loan's outstanding balance. Lending agreements may be classified based on how interest is calculated and how and when the borrower is required to make payments.

Loan Instruments

Mortgage

A mortgage loan is a loan secured by a voluntary lien on real property. In this arrangement, the borrower (the mortgagor) enters into a contract to borrow money and agrees that the lender (the mortgagee) may enforce the lien against the property if the borrower fails to repay the debt according to the terms of the loan agreement.

In most states (lien theory states), the borrower retains legal title to the property during and after repayment, while the lender holds only a lien interest. In some states (title theory states), a third party (the trustee) holds legal title to the property until the loan is paid in full.

Legal Theories of Mortgages: States generally follow one of two legal theories regarding the status of title to mortgaged property—lien theory or title theory.

These theories determine the rights and interests of the borrower and lender, particularly in the event of default and foreclosure. While often compared to the difference between a mortgage and a deed of trust, the legal theory primarily affects who holds legal title and the process used to foreclose.

Lien Theory: Most states follow the lien theory (also called the mortgage theory). In these states, a mortgage is treated as a lien on the borrower's property. The borrower (mortgagor) retains both legal and equitable title to the property during the loan repayment period. If the borrower defaults in a lien theory state, the lender must go through a judicial foreclosure process to enforce the lien, extinguish the borrower's rights, and sell the property to satisfy the debt. Florida is a lien theory state.

Title Theory: In a title theory state, legal title to the property is conveyed to a third party (the trustee) through a deed of trust, while the borrower retains equitable title. The trustee holds legal title on behalf of the lender until the loan is paid in full, at which point legal title is reconveyed to the borrower. Upon default, if the loan is secured by a deed of trust and state law permits, the lender may direct the trustee to initiate a nonjudicial foreclosure (power of sale).

Promissory Note: A promissory note is a written promise signed by the borrower (maker) to repay the lender (bearer), which specifies the amount of the debt, the interest rate, and the time and method of repayment. A promissory note is signed by a maker (borrower), who promises to repay the bearer (the lender). The words “or bearer” makes the note negotiable.

If the note is negotiable, the original lender may sell the note to another person. That person then replaces the initial lender with the legal right to demand repayment. The note need not be recorded because it only establishes a personal obligation.

Fannie Mae/Freddie Mac Uniform Florida Fixed-Rate Note for single-family property
This standardized note form was created within the Secondary Mortgage Market for Florida specific lending needs.

This note has a fixed interest rate that remains constant for the life of the loan and includes all of the loan specific items such as loan amount and term, repayment method, default and/or late payment provisions which protect the lender.

Nature of Mortgages and Deeds of Trust

Mortgages and deeds of trust (DOTs) are both real estate financing instruments that create a voluntary lien on real property until or unless the borrower repays a loan (borrower agrees to turn over the property if he defaults on the loan).

Mortgage Contract: The mortgage contract is a security instrument, which establishes that real property is collateral (hypothecation) for repayment of a debt. A promissory note without a mortgage contract is merely a personal obligation (unsecured by any collateral). Mortgage contracts should be recorded because they create liens on real property.

Deed of Trust: The typical DOT is a contract between three (3) parties—the borrower (trustor), the lender (beneficiary), and a neutral third person (trustee). Just like mortgages, DOTs are accompanied by promissory notes.

Assumption

The buyer takes title to the property and **agrees to assume personal responsibility** for the existing mortgage or deed of trust (DOT). This means the buyer becomes personally liable for repayment of the loan. If the lender approves the assumption, the buyer steps into the role of the original borrower. This may benefit the buyer if the existing loan has an interest rate lower than current market rates.

When a buyer assumes a mortgage, the buyer becomes personally liable for the debt. If the loan is not paid and a foreclosure sale does not satisfy the debt, the buyer who assumed the loan may be held responsible for the remaining balance through a deficiency judgment (if permitted by state law). Unless the lender releases the seller from liability (novation), the original borrower (seller) remains secondarily liable on the loan. In this case, the lender may pursue either or both parties for repayment of the debt. This is often described as joint and several liability.

Lender Approval: An assumption typically requires the lender’s approval, as most loan agreements contain a due-on-sale clause that may prohibit or restrict assumption unless the lender consents.

Original Borrower Remains Liable: In the event of a default by the assuming buyer, the original borrower (seller) generally remains liable for the debt unless the lender issues a novation releasing the seller from liability. In such cases, the lender may pursue either or both parties for repayment (often described as joint and several liability).

Reduction Certificate: A reduction certificate (also called an estoppel certificate) is a document that certifies the status of a loan as of a specific date, including the outstanding balance, interest rate, and maturity date. In many states, the lender (mortgagee) must provide this document upon request so that a prospective purchaser can verify the loan terms before assuming the loan or taking title subject to the existing financing.

Subject To

A buyer purchases property with an existing mortgage. Unlike an assumption, taking property “subject to” an existing mortgage means the buyer does not become personally liable for repayment of the debt.

If the loan is not repaid and the property is foreclosed, the subject-to buyer may lose the property, but is not personally liable for any deficiency. If the foreclosure sale does not produce enough funds to satisfy the debt, the lender may pursue the original borrower (seller/mortgagor) for the remaining balance through a deficiency judgment (if permitted by state law), but cannot pursue the subject-to buyer.

Substituting Lenders

Lenders may transfer their interest in a loan through an assignment or release liability through a novation.

An assignment is the transfer of the lender’s rights and interest in the loan (such as the note and security instrument) to another party, without changing the original terms of the loan.

A novation is the substitution of one party or agreement for another, which releases a party from liability and replaces the original obligation with a new one.

Satisfaction of Mortgage

When a borrower pays a mortgage loan in full, the lender issues a satisfaction of mortgage (also called a release or discharge of mortgage) and returns the cancelled note to the borrower. The satisfaction document must be recorded in the public records to provide notice that the lien has been released and the title is clear.

Deed of Trust (DOT) Release / Reconveyance

When a borrower pays a deed of trust (DOT) in full, the lender notifies the trustee and requests that the lien be released. The trustee then executes a deed of reconveyance (also called a release deed or certificate of satisfaction, depending on the state), which transfers legal title back to the borrower and removes the lien. The reconveyance deed **must be recorded** in the public records to clear the title.

Hypothecation

A common lending arrangement in which a borrower **pledges property as security** (collateral) for a loan while retaining the right to possess and use the property. A mortgage is a classic example of hypothecation.

As long as the borrower complies with the terms of the loan, the borrower retains exclusive use and enjoyment of the property, even though the lender holds a security interest (lien).

First Mortgages vs. Junior Mortgages

Secondary Financing: Loans that are subordinate to an existing mortgage (often referred to as junior liens).

Junior Mortgage: Any mortgage or lien that is subordinate in priority to a first mortgage. In the event of a borrower's default and foreclosure, the first mortgage lender has the primary claim on the property to satisfy the outstanding debt.

Junior (second, third, etc.) mortgage lenders are paid only from any remaining proceeds, if available, after the first mortgage has been fully satisfied. If foreclosure sale proceeds are insufficient, junior lienholders may receive nothing. Because of this increased risk, junior mortgages typically carry higher interest rates. Common examples include home equity loans and home equity lines of credit (HELOCs).

Lien Priority

Lien Priority refers to a lien's position in line relative to other liens, or the order in which creditors are paid if the property is sold. Priority may be determined by law (such as property tax liens), the date of recording, or the date the lien attaches to the property, depending on the type of lien and applicable state law. It is important for a creditor to record the lien promptly to establish and protect its priority against other creditors.

Liens generally follow the rule of "first in time, first in right." However, certain liens—such as **real estate tax liens and special assessments**—have priority over all other liens, regardless of when they are recorded.

A typical lien priority order is as follows:

1. Property tax liens and special assessments
2. First mortgages and other senior liens (based on recording)
3. Junior mortgages and other subordinate liens (in order of recording)
4. Unrecorded liens (generally lowest priority, subject to notice rules)

⚠️ Note: Mechanic's liens may have special priority rules in many states (often relating back to the date work began), and may take priority over some earlier-recorded liens depending on state law.

Subordination Agreement

A subordination agreement is a written agreement in which a lender holding a superior lien (such as a first mortgage) agrees to voluntarily move to a lower priority position in favor of another lien.

This agreement changes the normal priority order of liens, allowing a newer loan to take priority over an existing loan, even if it was recorded later.

Subordination agreements are commonly used in special financing situations and refinancing transactions, where a lender may require the new loan has a first lien position as a condition of making the loan.

Example: A homeowner has a first mortgage on their property.

They obtain a construction loan to improve the property.

👉 The construction lender requires first priority

👉 The original lender agrees to subordinate

Result:

Construction loan = new first lien

Original mortgage = now a junior lien

Wraparound Mortgage

A wraparound mortgage is a junior mortgage in which the new loan amount includes both new funds advanced and the remaining balance of an existing mortgage. The original mortgage is not paid off, but is instead “wrapped” into the new loan, resulting in a single payment from the borrower.

The wraparound lender collects payments from the borrower and remains responsible for making payments on the underlying (original) loan. The wraparound mortgage is subordinate to the original loan, meaning the original lender retains first priority.

Example: A seller still owes \$150,000 on an existing mortgage at 3% interest. A buyer wants to purchase the seller's property for \$200,000. Current market rates are 7% (so the existing loan rate is very attractive).

Instead of paying off the old loan, the seller creates a wraparound mortgage to the buyer for \$200,000 at 6% - this includes \$150,000 of the existing loan and \$50,000 in new financing from the seller. The buyer makes monthly payments at 6% to the wraparound lender (seller) and the seller then uses those funds to make the required payments on the existing underlying loan at 3%.

The seller makes money and the buyer gets the needed financing at a slightly reduced interest rate. Win, Win!

Types of Mortgages

Amortized Mortgage

Amortization is the process of repaying a loan through regular, periodic payments that include both principal and interest. Loans may be fully amortized or partially amortized.

Fully Amortized Loan: A fully amortized loan is repaid through equal periodic payments (typically monthly) so that the entire loan balance and all interest are reduced to zero by the end of the loan term.

Although the total payment amount remains constant, the portion applied to interest decreases over time, while the portion applied to principal increases over the life of the loan. These loans are commonly structured with terms such as 30 years or 15 years, although other term lengths may be available.

Amortization, Partially Amortized: A partially amortized loan is repaid through a series of regular, equal payments that include both principal and interest, but these payments are not sufficient to fully pay off the loan by the end of the term.

At maturity, the remaining balance becomes due as a balloon payment, which represents the unpaid principal balance.

A partially amortized mortgage typically results in lower periodic payments during the loan term, but requires a larger final payment. The final payment is greater than any previous payment—the payment “balloons” at maturity.

EXAMPLE: Partially Amortized Loan

Mr. Smith wants to borrow \$60,000 to open a small convenience store in a rural community. Local banks only loan money for seven years on such projects. However, a fully amortized seven year loan requires payments much higher than Mr. Smith could afford.

Because the bank determines that Mr. Smith poses little risk of defaulting on the loan, it agrees to loan Mr. Smith the money for seven years using a 20-year amortization table. This means that Mr. Smith’s monthly payments will be much lower, but he will have a large final payment when the loan becomes due in seven years.

Amortization, Negative (Negative Amortization): A loan structure in which the periodic payments are insufficient to cover the interest due, causing unpaid interest to be added to the loan balance (principal). As a result, the loan balance increases over time rather than decreases.

Payments under a negatively amortized loan may be less than the required interest, meaning that none of the payment is applied to principal, and some interest remains unpaid. This unpaid interest is capitalized (added to the principal), increasing the total amount owed.

Amortization Schedule: An amortization schedule is a table that shows how a loan is repaid over time. Based on the loan amount, interest rate, and term, it breaks down each payment into principal and interest, and shows the remaining loan balance after each payment period.

Adjustable Rate Mortgage

An adjustable rate mortgage (ARM) is a long-term loan in which the interest rate changes periodically based on a specified index plus a margin. The loan is typically amortized over a set term (such as 30 years), even though the interest rate may adjust during that period.

ARMs often begin with an initial fixed-rate period (such as 3, 5, 7, or 10 years), after which the interest rate adjusts at regular intervals (such as annually). The rate is not renegotiated, but instead adjusts automatically according to the terms of the loan agreement.

The interest rate may increase or decrease depending on changes in the underlying index, which causes the borrower's payment amount to change over time.

Calculating the Interest Rate: The lender selects the index used for the loan at the time of application, and this generally remains the same throughout the life of the loan. The margin is a fixed number of percentage points added to the index to determine the fully indexed rate after the initial rate period ends.

Teaser Rates: A teaser rate is an introductory interest rate that is lower than the fully indexed rate. Adjustable-rate mortgages (ARMs) often feature a low initial rate for a set period to make the loan more attractive to borrowers. After this initial period, the interest rate adjusts based on the index and margin, which may result in a higher payment.

Interest Rate Caps: A cap limits how much the interest rate or payment can increase. Most ARMs include several types of caps to protect borrowers from large increases.

Initial Adjustment Cap: Limits interest rate increases at the first adjustment after the initial fixed-rate period.

Periodic (Subsequent) Cap: Limits interest rate changes during each adjustment period after the first.

Lifetime Cap: Limits interest rate increases over the entire life of the loan.

Payment Cap: Limits how much the monthly payment can increase at each adjustment.

Balloon Payment: A balloon payment is the remaining loan balance due in full at the end of a loan term. For example, a loan may have a 5-year term with payments based on a longer amortization period, resulting in a large final payment at maturity. More common in commercial real estate.

Package Mortgage

A package mortgage is a loan secured by **both real property and personal property** (such as appliances included in the sale). More common in specialized/commercial transactions.

EXAMPLE: Package Mortgage

A home loan that includes the washer, dryer, and refrigerator as collateral is a package mortgage.

Home Equity Loan

A home equity loan is a loan secured by the borrower's equity in real estate. It may be structured as a junior lien (most commonly a second mortgage, but can also be third), and typically has a fixed interest rate with a lump-sum disbursement. Home equity financing is often used for purposes such as home improvements, debt consolidation, or other major expenses.

A related product, a home equity line of credit (HELOC), allows the borrower to draw funds as needed up to a specified limit and usually has an adjustable interest rate.

Reverse Mortgage (Home Equity Conversion Mortgage – HECM)

A reverse mortgage is a loan that allows a homeowner (typically age 62 or older) to convert home equity into cash, which may be received as periodic payments, a lump sum, or a line of credit.

The loan balance increases over time as interest accrues and payments are made to the borrower. Repayment is generally required when a triggering event occurs, such as the death of the borrower, sale of the home, or the borrower no longer occupying the property as a primary residence.

Most reverse mortgages are **non-recourse loans**, meaning the borrower (or estate) will never owe more than the value of the home at the time of repayment.

Home Equity Conversion Mortgage (HECM)

The Home Equity Conversion Mortgage (HECM) is the Federal Housing Administration (FHA) reverse mortgage program that allows eligible homeowners (generally age 62 or older) to convert a portion of their home equity into cash.

Borrowers may choose to receive funds in several ways, including monthly payments, a line of credit, a lump sum, or a combination of these options.

A HECM may also be used to purchase a primary residence (known as a HECM for Purchase), provided the borrower contributes sufficient cash at closing to cover the difference between the loan proceeds and the purchase price plus closing costs.

The following qualifications apply, applicants must:

- Be 62 years of age or older
- Own the property outright or have a low mortgage balance that can be paid off with HECM proceeds
- Occupy the property as a principal residence
- Not be delinquent on any federal debt
- Participate in a consumer information session provided by a HUD-approved HECM counselor

Eligible Property Types

Eligible properties must meet FHA property standards and flood requirements, and include:

- Single-family homes or 1–4 unit properties (with one unit occupied by the borrower)
- HUD-approved condominiums
- Manufactured homes that meet FHA requirements

Purchase Money Mortgage

A purchase money mortgage (PMM) is a mortgage in which the seller provides financing to the buyer as part of the purchase transaction. The seller extends credit to the buyer, often when the buyer cannot obtain full financing from a traditional lender.

The mortgage and transfer of title occur simultaneously, making it part of the same transaction.

The amount of the loan cannot exceed the unpaid portion of the purchase price.

A purchase money mortgage is often used in combination with an institutional loan, resulting in the seller's loan being a junior lien.

Open-End Mortgage

An open-end mortgage is a loan secured by real property in which the lender establishes a maximum loan amount, and the borrower may borrow funds as needed (draws) up to that limit over time.

The borrower typically pays interest only on the amount actually borrowed, not the full approved amount. As principal is repaid, funds may be re-borrowed, similar to a line of credit.

Open-end mortgages are **commonly used in construction financing**, where funds are disbursed in stages as portions of the project are completed.

Blanket Mortgage

A blanket mortgage is a loan in which the borrower pledges multiple parcels of real estate as collateral for a single debt. These loans typically include a partial release clause, allowing individual parcels to be released from the lien as portions of the loan are repaid. Blanket mortgages are commonly used by builders and developers to finance large tracts of land that will later be subdivided and sold.

Takeout Commitment

A takeout commitment is a lender's promise to provide permanent, long-term financing that will replace an existing short-term loan, such as a construction loan. When the long-term loan is funded, it "takes out" the interim financing, paying off the original lender.

Special Lending Agreements to Control Interest

Renegotiable Rate Mortgage (RRM)

A renegotiable rate mortgage (RRM) is a type of adjustable-rate mortgage (ARM) in which the interest rate is reset at specified intervals (such as every 3–5 years) based on current market conditions.

Unlike most modern ARMs that adjust automatically using an index and margin, an RRM traditionally involves the lender offering a new rate at each reset period, which the borrower may accept or, in some cases, refinance or repay the loan.

The loan is typically amortized over a long-term period (such as 30 years), even though the rate is reset periodically.

Buydown Mortgage

A buydown is a financing technique in which funds are paid upfront to reduce the borrower's interest rate—and therefore monthly payments—during the initial years of the loan.

This upfront payment is often made by the seller, builder, or lender as an incentive to help the borrower qualify for financing, particularly in high interest rate environments.

In a temporary buydown, the interest rate is reduced for a set period (such as a 2-1 buydown), after which the rate increases to the original note rate.

Progress Check - Finance

1. Which type of mortgage is used mostly by the elderly to supplement income?
 - A. Reverse mortgage
 - B. Open ended mortgage
 - C. Purchase money mortgage
 - D. Adjustable rate mortgage

2. Which of the following is incorrect regarding promissory notes?
- A. They do not have to be recorded
 - B. It specifies the amount of debt, interest rate and repayment term
 - C. The parties are the "maker" and the "bearer"
 - D. They cannot be sold or transferred
3. What is the best example of hypothecation?
- A. A mortgage
 - B. A power of attorney
 - C. An escrow account
 - D. A foreclosure

MORTGAGE ELEMENTS & FEATURES

Learning Objectives

- Identify common mortgage covenants, clauses, and note provisions found in real estate loans.
- Differentiate among mortgage clauses such as acceleration, due-on-sale, defeasance, prepayment, reinstatement, and power of sale.
- Explain the purpose of down payments, borrower equity, and lender risk analysis.
- Calculate and interpret loan-to-value (LTV) and debt-to-income (DTI) ratios.
- Differentiate between note rate, APR, and rate lock concepts.
- Explain PITI, escrow accounts, and the components of a monthly housing payment.
- Explain how discount points affect lender yield and borrower closing costs.

- Recognize when private mortgage insurance (PMI) is typically required and when cancellation may occur.
- Understand common loan term structures, including standard amortized loans and balloon-payment loans.
- Identify common borrower costs and features associated with mortgage financing.

Mortgage Elements

Covenants. The following covenants (contractual promises) and clauses (contractual conditions) may appear in both mortgages and DOTs:

Covenant to Pay Indebtedness: Borrower’s promise to repay the loan according to loan terms.

Covenant to Pay Insurance: Borrower’s promise to maintain insurance coverage against damage or destruction of financed property (amount specified by lender, lender as beneficiary).

Covenant to Pay Taxes: Borrower’s promise to pay real estate taxes and other assessments levied against property.

Covenant of Good Repair: Promise that obligates the borrower to maintain the mortgaged property and keep it in good repair.

Clauses. The following clauses (contractual conditions) may appear in both mortgages and DOTs:

Acceleration Clause: Specifies that if the borrower defaults (such as by violating loan covenants), the entire remaining loan balance becomes immediately due and payable. In other words, the loan is “accelerated” to full maturity. The lender may accelerate the loan only if this clause is included in the loan documents. In most cases, the lender must provide the borrower with notice of default and an opportunity to cure within a specified time period, as required by the loan terms and/or applicable law.

EXAMPLE Acceleration Clause: A mortgage might accelerate a note if the borrower failed to pay his installment; or if the borrower committed harmful waste or failed to keep the premises in repair, thereby seriously endangering the value of the mortgaged property.

Alienation Clause (Due-on-Sale Clause): A clause that provides the lender may demand full repayment of the loan if the borrower transfers any ownership interest in the property without the lender's consent. This type of clause is commonly called a due-on-sale clause. In effect, this clause generally makes the loan non-assumable without the lender's approval.

Under federal law (the Garn–St. Germain Depository Institutions Act), lenders are generally permitted to enforce due-on-sale clauses, although certain limited exceptions apply (such as specific transfers between family members or into certain trusts).

Defeasance Clause: A clause that provides for the cancellation (defeat) of the mortgage or deed of trust when the borrower has fully repaid the debt. At that point, the lien is extinguished and the borrower is restored to full ownership rights.

Although the defeasance clause provides for cancellation of the lien, a satisfaction of mortgage or deed of reconveyance (release) must be recorded in the public records to provide notice that the lien has been released and to clear title.

Prepayment Clause: A clause that specifies whether the borrower may repay all or part of a loan before maturity, and whether a prepayment penalty will be charged.

FHA and VA loans prohibit prepayment penalties.

If a loan does not include a prepayment penalty clause, the borrower may generally prepay the loan without penalty. However, whether a loan may be prepaid at all (in whole or in part) depends on the terms of the note and applicable state law.

Right to Reinstate: A clause that gives the borrower the right to cure a default and avoid foreclosure by paying all past-due amounts, including missed payments, late fees, and any permitted costs and expenses (such as attorney's fees), within a specified time period.

Once the default is cured, the loan is reinstated, and foreclosure proceedings are typically stopped.

Power of Sale Clause: A clause, commonly found in a deed of trust, that authorizes the trustee to sell the property if the borrower defaults on the loan. This allows the lender to foreclose through a non-judicial foreclosure process, meaning without a court proceeding.

Power of sale foreclosure is most commonly used in deed of trust states. In these cases, the trustee, not the lender, conducts the sale (typically at a public auction) on behalf of the lender.

Exculpatory Clause: A clause in which the lender agrees to waive the right to pursue a deficiency judgment against the borrower. This means the borrower is not personally liable for any remaining debt if the foreclosure sale proceeds are insufficient to satisfy the loan.

Inspection Clause: A clause that allows the lender to inspect the property if there is reasonable cause, such as suspected default or deterioration of the property. The lender may enter the property for inspection, typically subject to reasonable notice requirements, unless otherwise permitted by the loan terms or law.

Condemnation Clause: A clause that provides the lender is entitled to any condemnation (eminent domain) proceeds, to the extent necessary to protect its security interest in the property.

Common Mortgage Features

Down Payment: The portion of the purchase price that the borrower pays in cash.

Conventional loans often require a larger down payment than government-backed loans.

Many lenders require a 20% down payment (80% LTV) to avoid private mortgage insurance (PMI), although lower down payment options are commonly available.

Loan-to-Value Ratio (LTV): The ratio between a mortgage loan amount and the value of the property, based on the lower of the sales price or appraised value (calculated by dividing the loan amount by the property value).

Lenders analyze LTV and establish maximum ratios to reduce the risk of borrower default. The higher the LTV, the lower the down payment, because the lender is financing a greater portion of the purchase price. Conversely, the lower the LTV, the higher the down payment, because the borrower contributes more equity. Higher LTV ratios represent greater risk to the lender, as borrowers with less equity are generally considered more likely to default.

EXAMPLE LTV: A buyer pays \$110,000 for a house that is appraised at \$100,000, and a lender loans \$80,000. The LTV is based on the lower value (\$100,000):

$$LTV = 80,000 \div 100,000 = 0.80 = 80\%$$

Debt-to-Income Ratios (DTI): After determining a borrower's monthly income, housing expenses, and debt obligations, the underwriter calculates key ratios used in the loan underwriting process.

Housing Expense Ratio (Front-End Ratio): This ratio compares a borrower's monthly housing expenses (PITI) to gross monthly income. Many lenders use a guideline of approximately 28% or less, although acceptable ratios may vary depending on the loan program. To calculate this ratio, divide the borrower's monthly housing expenses by gross monthly income.

EXAMPLE: A borrower's monthly housing expenses are \$1,000, and monthly income is \$4,000.

$$Housing\ Expense\ Ratio = 1,000 \div 4,000 = 0.25 = 25\%$$

Total Obligations Ratio (Back-End Ratio): This ratio compares a borrower's total monthly debt obligations to gross monthly income. Many lenders use a guideline of approximately 36% or less, although acceptable ratios may vary depending on the loan program.

To calculate this ratio, the underwriter adds all monthly obligations (including housing expenses, student loans, credit cards, auto loans, etc.) and divides that total by the borrower's gross monthly income.

EXAMPLE: Total Obligations Ratio:

A borrower's monthly housing expenses are \$1,000, income is \$4,000, and other credit obligations are \$400.

Total Obligations Ratio = $(1,000 + 400) \div 4,000 = 1,400 \div 4,000 = 0.35 = 35\%$

Equity: The value of a property minus all debts secured by it. Equity represents the owner's financial interest in the property. You can calculate equity by subtracting the total loan balance(s) (including the primary mortgage and any home equity loans or lines of credit) from the property's current market value.

EXAMPLE Equity:

A buyer purchases a house for \$100,000 with a \$20,000 down payment and an \$80,000 mortgage. The owner's initial equity is \$20,000.

Ten years later, the owner sells the house for \$150,000. Over that time, she has paid down the loan balance by \$40,000, leaving \$40,000 still owed.

Equity = $150,000 - 40,000 = 110,000$

Interest, APR, and Rate Lock: Interest is the cost of borrowing money, calculated as a percentage of the loan's principal (the amount borrowed). Most real estate loans calculate interest based on the remaining loan balance (simple interest) and are repaid through amortization, meaning equal periodic payments that gradually reduce the loan balance over time.

The Annual Percentage Rate (APR) represents the total cost of credit expressed as a yearly rate and includes not only the interest rate, but also points and certain lender fees.

A rate lock is a lender's promise to hold a specific interest rate (and possibly points) for a set period of time, protecting the borrower from interest rate increases while the loan is being processed.

Factors Affecting Interest Rates

Interest rates vary based on several factors, including loan term, loan size, and risk level. Shorter-term loans (such as 15-year mortgages) typically have lower interest rates than longer-term loans (such as 30-year mortgages). Loans considered higher risk—such as larger, non-conforming loans—may carry higher interest rates. Additionally, lenders may adjust rates based on the profitability and risk associated with the loan.

PITI: PITI is an abbreviation for Principal, Interest, Taxes, and Insurance, the four components of a typical monthly mortgage payment. Borrowers pay principal and interest toward the loan, and typically pay property taxes and insurance into an escrow (reserve) account maintained by the lender. Together, these components make up the total monthly housing payment.

Discount Points and Loan Yield: Discount points are prepaid interest that a borrower may pay to a lender at closing in exchange for a reduced interest rate on the loan. Lenders use discount points to adjust the yield (return) on a loan to meet their desired profitability.

By charging points upfront, the lender can offer a lower interest rate while still achieving an acceptable return. Borrowers may choose to pay points to reduce their monthly payments over the life of the loan.

Discount points are paid as a lump sum at closing, and one point equals 1% of the loan amount.

Discount points allow a lender to increase the effective yield (lender's actual return (profit)) on a loan while offering the borrower a lower stated interest rate. By collecting prepaid interest upfront, the lender improves the overall return on the loan.

For example, a lender may require a certain number of points to offset a lower interest rate requested by the borrower. The exact number of points needed to adjust the

lender's yield and lower the borrower's interest rate varies based on market conditions and loan terms and is not fixed.

The cost to the buyer: 1 point = the dollar amount equal to 1% of loan.

Example: On a \$150,000 loan, one discount point equals \$1,500 (1% of the loan amount).

Private Mortgage Insurance (PMI): Insurance that protects the lender against loss if a borrower defaults on a conventional mortgage. Lenders typically require PMI when a loan has a loan-to-value (LTV) ratio greater than 80%.

For loans requiring PMI, the borrower pays an insurance premium, which may be paid upfront at closing, monthly, or as part of the loan, depending on the loan structure.

Under federal law, borrowers may request cancellation of PMI once the loan reaches 80% LTV, and lenders are generally required to automatically terminate PMI at 78% LTV (based on the original property value), provided the borrower is current on payments.

EXAMPLE: Private Mortgage Insurance:

A home is appraised at \$100,000, and the buyer has a \$10,000 down payment (10%). This means the buyer needs a \$90,000 loan (90% LTV).

Because the loan exceeds 80% LTV, the lender requires private mortgage insurance (PMI). PMI protects the lender by covering a portion of the loss if the borrower defaults.

As a result, the lender is willing to approve the 90% loan, even though it involves higher risk.

Term: The period of time over which a loan is scheduled to be repaid. Common loan terms include 30 years and 15 years, meaning the loan is structured to be fully repaid over that time period.

Some loans have shorter terms (such as 5–7 years) but may be structured with a longer amortization period, resulting in a balloon payment at the end of the term. A

balloon payment is a large final payment representing the remaining loan balance due at maturity.

Progress Check - Mortgage Elements & Features

1. Conventional lenders typically require private mortgage insurance when the loan-to-value ratio is greater than _____.

- A. 75%
- B. 80%
- C. 85%
- D. 90%

2. When a borrower signs a mortgage they agree to pay the loan amount, insurance, taxes and keep the property in good repair based on the mortgage _____.

- A. Clauses
- B. Term
- C. Covenants
- D. Contingencies

3. A borrower obtains a \$200,000 loan and agrees to pay 2 discount points. How much will the borrower pay in points at closing?

- A. \$2,000
- B. \$4,000
- C. \$20,000
- D. \$40,000

LOAN QUALIFICATIONS & SOURCES OF FINANCING

Learning Objectives

- Explain the mortgage qualification process, underwriting factors, and qualifying ratios.
- Differentiate between prequalification and preapproval.
- Explain the role of collateral, appraisal review, and title review in loan approval.
- Recognize common conventional loan features including LTV benchmarks and PMI requirements.
- Describe the characteristics of FHA-insured mortgages and common FHA loan programs.
- Explain FHA borrower costs including upfront and annual mortgage insurance premiums.
- Explain the VA loan guaranty program, borrower eligibility, entitlement, and common VA loan features.
- Identify common lender commitments such as firm, conditional, lock-in, and takeout commitments.
- Distinguish among the primary sources of residential financing, including banks, credit unions, mortgage bankers, brokers, and insurance companies.
- Recognize seller-financing methods such as land contracts or contracts for deed.

Qualifying for a Loan

Loan Application Procedures: To apply for most mortgage loans, the borrower must complete a standard federal form known as the Uniform Residential Loan Application (FNMA Form 1003).

Under federal law (TRID rules), a mortgage loan application is considered received once the lender obtains the following six pieces of information: the borrower's name, monthly income, Social Security number (to obtain a credit report), the property address, an estimate of the property's value, and the mortgage loan amount sought.

Once the application is submitted, the lender will typically request supporting documentation, such as W-2s or tax returns, bank statements, purchase contracts, and proof of additional income (e.g., retirement or benefits).

It is a federal crime to provide false or misleading information on a loan application or in any supporting documentation. Applications may be submitted in writing, electronically, or as a written record of an oral application.

Collateral: Money or property pledged by a borrower to a lender as security for repayment of a debt. Mortgage lenders reduce risk by requiring borrowers to pledge real property as collateral. If the borrower defaults on the loan, the lender may recover the debt by foreclosing on the property and forcing its sale.

Credit evaluation and credit scoring (F.S. 494.001). A lender will examine a borrower's creditworthiness when evaluating a loan application. To determine this, the loan underwriter reviews the borrower's credit report for evidence of debt repayment history and overall financial behavior.

“Credit report” means any written, oral, or other information obtained from a consumer reporting agency, as defined in the federal Fair Credit Reporting Act (FCRA), that bears on an individual's creditworthiness, credit standing, or credit capacity. A credit score alone is not considered a credit report.

“Credit score” means a numerical value, grade, or rating derived from data in a credit report using a model or algorithm, whether through computer software or another process, for the purpose of ranking or evaluating credit risk.

Compensating Factors. No two borrowers have identical credit and income profiles, so underwriters evaluate more than just the information contained in the loan application. They consider additional factors to determine the borrower's overall credit risk before rendering a decision on loan approval.

For example, a borrower may fall outside a lender's standard guidelines (or those of a secondary mortgage market investor), but still demonstrate strong compensating factors that indicate a lower risk of default. These may include:

- a consistent savings history
- long-term employment stability
- a pattern of paying more than the minimum required on credit obligations

- a substantial down payment
- significant cash reserves after closing

Property Analysis. An underwriter will review the appraisal report to ensure the property provides adequate collateral value for the loan. The goal is not to confirm the exact purchase price, but to verify that the property's market value supports the loan amount.

If questions arise, the underwriter may request additional documentation, a reconsideration of value (ROV), or a review appraisal. A review appraisal may involve a desk review of the original report or, in some cases, a second appraisal performed by a different appraiser.

The underwriter will also review the title commitment to confirm there are no issues—such as liens, defects, or encumbrances—that could negatively affect the lender's security interest in the property if the borrower defaults.

Qualifying Borrowers and Collateral: Even with collateral, lenders assume risk when making loans due to potential foreclosure costs, legal requirements, and fluctuations in market value. To reduce this risk, lenders evaluate both the borrower's ability to repay and the adequacy of the collateral.

Lenders assess the borrower's ability to repay by analyzing factors such as credit history, employment stability, income, and overall financial profile. At the same time, the lender evaluates the property by estimating its market value through an appraisal.

If both the borrower and the property meet the lender's standards, the lender may determine the loan is an acceptable risk and will lend a percentage of the property's value, commonly expressed as the loan-to-value (LTV) ratio.

Pre-Qualification: An informal estimate—often based on unverified information provided by the borrower—of how much the borrower may be able to afford to borrow. This may occur over the phone or online and typically does not involve documentation review.

Pre-Approval: A lender's conditional commitment to lend to a specific borrower, issued after the borrower completes a loan application and the lender reviews credit, income, and financial documentation. Pre-approval is subject to conditions such as property appraisal, title review, and final underwriting.

Sources of Financing

Conventional Loans

A conventional loan is a mortgage originated by private lenders in the primary market that is not insured or guaranteed by a government agency (such as FHA or VA).

Although not government-backed, these loans are often influenced by the underwriting standards of secondary market investors such as Fannie Mae (FNMA) and Freddie Mac (FHLMC). As a result, conventional loans may present greater risk to lenders than government-backed loans, since there is no government insurance or guarantee to offset potential losses.

Down Payments: The borrower's down payment is the portion of the purchase price paid in cash.

Conventional loans may allow for lower down payments (in some cases as low as 3%–5% for qualified borrowers), but if the loan-to-value (LTV) ratio exceeds 80%, the borrower is typically required to pay private mortgage insurance (PMI). A 20% down payment (80% LTV) is commonly used to avoid PMI, but it is not always required to obtain a conventional loan.

Loan-to-Value Ratio (LTV). The loan-to-value ratio (LTV) is calculated by dividing the loan amount by the lower of the sales price or appraised value of the property:

$$\text{LTV} = \text{Loan Amount} \div \text{Lower of (Sales Price or Appraised Value)}$$

An 80% LTV is commonly used as a benchmark because it allows the borrower to avoid private mortgage insurance (PMI), but it is not required to obtain a conventional loan.

EXAMPLE LTV:

A buyer purchases a home for \$386,000, and the property appraises for \$387,000. Because lenders use the lower of the two values, the calculation is based on \$386,000.

If the lender provides a loan of \$310,000, the LTV is:

$$310,000 \div 386,000 = 0.80 = 80\%$$

The borrower must pay the difference between the purchase price and the loan amount:

$$386,000 - 310,000 = 76,000$$

Government Insured FHA Program

Government programs that insure or guarantee mortgage loans provide an alternative for borrowers who may not qualify for a conventional loan.

Federal Housing Administration (FHA). The Federal Housing Administration, part of the U.S. Department of Housing and Urban Development (HUD), provides mortgage insurance on loans made by FHA-approved lenders throughout the United States and its territories.

- ✓ FHA insures (but does not originate) loans on 1–4 family residential properties and certain manufactured homes.
- ✓ FHA-insured loans are generally assumable (subject to lender qualification), and there are no prepayment penalties.
- ✓ FHA mortgage insurance reduces the lender’s risk of loss in the event of borrower default.

Nature of FHA Loans. Primary market lenders qualify borrowers and property according to FHA guidelines, which are generally less stringent than conventional loan standards, and originate various types of mortgage loans (such as fixed-rate and adjustable-rate mortgages).

The borrower pays FHA mortgage insurance (MIP). In the event of default, the lender files a claim with FHA to recover a portion of the loss, thereby reducing the lender's risk.

Principal Advantage of FHA Loans. FHA loans allow borrowers to make lower down payments (resulting in higher LTV ratios) than typically permitted by conventional loans.

Borrowers may qualify for a down payment as low as 3.5%, which corresponds to a maximum LTV of 96.5%. These lower down payment requirements are possible because FHA insurance protects the lender against loss, allowing borrowers to finance a larger portion of the property's value.

Basic FHA Standards. FHA Mortgage Insurance: FHA borrowers must pay mortgage insurance premiums (MIP). This includes both an upfront mortgage insurance premium (UFMIP) and an annual (monthly) mortgage insurance premium.

For most FHA-insured loans, the upfront MIP is 1.75% of the base loan amount and is typically paid at closing, although it may be financed into the loan.

Lenders are required to remit the upfront MIP to FHA within 10 calendar days after closing or disbursement, whichever is later.

In addition to the upfront premium, borrowers must pay an annual MIP, which is paid in monthly installments as part of the mortgage payment.

The annual MIP is based on factors such as the loan term, loan amount, and loan-to-value (LTV) ratio.

Annual MIP rates generally range from approximately 0.45% to 1.05% of the loan amount.

Higher LTV ratios, larger loan amounts, and longer loan terms typically result in higher annual MIP rates.

FHA mortgage insurance premium (MIP) duration depends on the loan-to-value (LTV) ratio at origination:

- ***Mortgages with an LTV Greater Than 90%:*** Annual MIP is required for the entire loan term (life of the loan).

- ***Mortgages with an LTV Less Than or Equal to 90%:*** Annual MIP is required for 11 years.

Qualifying Borrowers: FHA insures loans only when the property, lender, and borrower meet established FHA guidelines.

These guidelines address areas such as minimum property standards, acceptable construction methods, use of FHA-approved appraisers, evaluation of the borrower's creditworthiness, and lender approval requirements.

FHA also establishes maximum loan limits based on geographic area.

Income: There is no specific minimum income requirement to qualify for an FHA-insured loan; however, borrowers must demonstrate stable and reliable income, typically for at least two years.

Acceptable income sources may include wages, seasonal employment, retirement income, Social Security, VA benefits, alimony, and child support (if voluntarily disclosed).

Additional income such as part-time work, overtime, and bonuses may be considered if there is a consistent history of receipt.

Debt-to-Income Ratio (DTI): FHA guidelines generally limit DTI to 31% (housing) and 43% (total debt). Conventional loans often use 28% / 36% as a benchmark.

Borrowers may exceed FHA ratios if they have strong compensating factors, such as:

- Stable income and good credit history
- Significant savings or cash reserves
- Large down payment
- Minimal increase in housing expense
- Additional income potential

Income Stability: Lenders evaluate the borrower's employment history, job consistency, and likelihood that income (including bonuses or overtime) will continue.

Credit Score: FHA guidelines are generally more flexible than conventional loans, allowing for lower credit scores or limited credit history.

Qualifying Collateral: FHA requires the use of approved appraisers to evaluate the property's value and condition in accordance with FHA standards.

Maximum Loan Amounts: FHA sets limits on the loan amounts it will insure, which vary by location based on housing costs.

Closing Costs: FHA regulates which closing costs are allowable. Many non-allowable costs are typically paid by the seller or lender.

Example: The origination fee may not exceed 1% of the loan amount.

Assumption. FHA loans are generally assumable, provided the lender approves the new borrower and the assuming borrower meets creditworthiness requirements.

Prepayment. FHA-insured loans do not have prepayment penalties. Borrowers may pay off the loan early or make additional principal payments at any time without penalty.

Section 203(b): Basic Home Mortgage Loan

The 203(b) program is FHA's primary loan program used to purchase or refinance a principal residence (1–4 family property). The loan is originated by an approved lender and insured by FHA (HUD).

Key Features:

- Must meet FHA credit and income qualifications
- Up to 96.5% financing (3.5% down payment)
- Upfront and annual mortgage insurance (MIP) required
- May be used with fixed-rate or adjustable-rate mortgages

U.S. Department of Veterans Affairs (VA) loans

VA home loans are guaranteed by the U.S. Department of Veterans Affairs (VA) for eligible veterans, active-duty service members, and certain surviving spouses to purchase, build, or refinance a home.

The program was established under the Servicemen's Readjustment Act of 1944 (GI Bill).

In most cases, the VA does not lend money directly. Instead, it guarantees loans made by VA-approved lenders. However, the VA may make direct loans in limited situations (such as certain rural areas or through specific VA programs).

Nature of VA Loans. Primary market lenders evaluate eligible borrowers and properties according to VA guidelines, then originate the loan (fixed-rate, adjustable-rate, etc.).

The VA guarantees a portion of the loan, reducing the lender's risk in the event of borrower default.

If a borrower defaults, the lender may pursue foreclosure, and the VA guaranty helps cover a portion of the lender's loss.

If eligible for a VA-guaranteed home loan, a borrower may use the loan to:

- Buy a primary residence (including a single-family home or approved condominium)
- Build a home
- Purchase and improve/renovate a home
- Refinance an existing non-VA loan (cash-out refinance)
- Refinance an existing VA loan to reduce the interest rate (IRRRL/streamline)
- Purchase a manufactured home that will be permanently affixed to land (with or without purchasing the land)

Principal Advantage of VA Loans

- Little or no down payment required
- No monthly mortgage insurance

- VA guarantees a portion of the loan, reducing lender risk

Basic Entitlement: The VA guarantees a portion of the loan (typically 25%), reducing lender risk. Borrowers with full entitlement generally have no loan limits and may qualify for 100% financing.

Maximum Loan Amount: The lender (not the VA) determines the loan amount and interest rate based on the borrower's qualifications. The VA does not set a maximum loan amount for borrowers with full entitlement.

However, the VA limits the amount it will guarantee and will not guarantee a loan that exceeds the property's reasonable value, as determined by a VA appraisal (Certificate of Reasonable Value).

Borrowers with full entitlement may qualify for 100% financing, while those with remaining (partial) entitlement may be subject to loan limits and may need to make a down payment.

Qualifying Borrowers: The VA establishes eligibility standards for borrowers seeking VA-guaranteed loans. However, VA-approved lenders determine whether a borrower qualifies based on credit, income, and underwriting guidelines.

- ***Active Duty:*** Eligibility is generally based on meeting minimum service requirements, such as 90 days during wartime or 181 days during peacetime, along with a discharge other than dishonorable (or current active-duty status).
- ***Certificate of Eligibility (COE):*** The VA issues a Certificate of Eligibility (COE) to verify that a borrower meets the service requirements for the VA loan program. The COE informs the lender that the borrower is eligible for the VA guaranty, but it does not guarantee loan approval, which is determined by the lender.

Qualifying Collateral & Lending Restrictions

Appraisal / CRV: VA requires an appraisal to determine the property's reasonable value. The Certificate of Reasonable Value (CRV) establishes the maximum loan amount guaranteed.

Closing Costs & Terms:

- VA limits allowable closing costs (including up to a 1% origination fee)

- No mortgage insurance required
- No down payment required if the price does not exceed appraised value
- If the price exceeds value, the borrower must pay the difference in cash

Funding Fee: The VA charges a funding fee for most VA loans; this helps offset program costs.

- First use: typically 2.15% of the loan amount (no down payment)
- Subsequent use: typically 3.30% (no down payment)
- 5%–9.99% down payment: 1.50%
- 10% or more down payment: 1.25%

The funding fee is paid at closing but may be financed into the loan amount.

Some borrowers, such as those with service-connected disabilities, may be exempt from the funding fee.

Assumption: VA-guaranteed loans are assumable, even by non-veterans, subject to lender approval and credit qualification.

These loans may also be prepaid at any time without penalty.

Interest rates are set by the lender, not the VA.

Eligibility Restoration: VA loan eligibility may be reused if the prior VA loan has been paid in full and the property sold. In addition, a one-time restoration may be granted if the prior VA loan is paid in full but the borrower still owns the property.

Loan Commitment: A written promise from a lender indicating loan approval.

Types of Commitments:

- Firm commitment: Final approval (most common)
- Lock-in commitment: Interest rate guaranteed for a set period
- Conditional commitment: Approval subject to specific conditions

- Take-out commitment: Replaces an existing loan (often used in construction financing)

Primary Sources of Home Financing

Depository Lenders: Depository lenders, such as banks and savings and loan associations, accept deposits from the public (often interest-bearing) and use those funds to make loans.

Non-Depository Lenders: Non-depository lenders, such as finance companies and mortgage companies, do not accept deposits, but instead obtain funds from investors or other sources.

Both types act as financial intermediaries, borrowing money from one group (depositors or investors) and lending it to borrowers at a profit.

Financial Institutions

Act as intermediaries, obtaining funds from depositors and lending to borrowers to earn a return. Examples: commercial banks, savings and loans, credit unions, insurance companies.

Commercial Banks:

- Provide a variety of loans (business, construction, residential)
- Funded primarily by checking accounts (demand deposits)
- Focus on short-term, liquid loans
- Often sell loans on the secondary market

Savings and Loan Associations (S&Ls): Financial institutions that focus on home financing and savings.

- Accept deposits (often with competitive interest rates)
- Provide primarily residential mortgage loans (1–4 units)
- Make both conventional and government-backed loans (FHA/VA)
- May buy and sell loans on the secondary market

- Federally insured deposits (up to \$250,000) through the FDIC

Credit Unions: Credit unions are non-profit, member-owned financial institutions that operate similarly to banks. Membership is typically based on a common bond (such as employer, association, or community).

- Offer a range of loan products, including residential mortgages
 - May provide competitive interest rates and fees
 - Often emphasize personalized service
 - Lending standards may be more flexible in some cases, but borrowers must still meet underwriting requirements
-
- **Mortgage Bankers:** Primary lenders (individuals, firms, or corporations) that originate and fund loans using borrowed funds or warehouse lines of credit, then sell those loans on the secondary market. Mortgage bankers close loans in their own name, assume the risk during origination, and may service the loans even after they are sold. Unlike commercial banks and savings institutions, mortgage bankers do not accept deposits.
 - **Mortgage Loan Originator (MLO):** The MLO works with the borrower from application through closing. The MLO is typically the loan officer, while the lender is the institution funding the loan.
 - **Mortgage Brokers:** Act as intermediaries, connecting borrowers with lenders. They do not fund or service loans, but may charge a fee for arranging the loan.

Insurance Companies: Primary lenders focused on long-term, stable investments. They are major investors in commercial real estate, such as office buildings, apartment complexes, and shopping centers.

Life insurance companies also participate in the residential market, primarily by purchasing mortgage-backed securities or pools of loans on the secondary market.

In some cases, insurance companies may also be involved in originating residential loans, often through intermediaries such as mortgage bankers or brokers.

Seller Financing

Land Contract (Contract for Deed): A method of seller financing in which the buyer receives equitable title, while the seller retains legal title until the buyer completes all installment payments.

Unlike a traditional mortgage, buyers under a land contract typically have fewer protections in the event of default, and may risk losing the property and payments made.

A land contract (also called an Agreement for Deed or Contract for Deed) is a written, bilateral, executory contract in which the parties agree to transfer ownership once the terms are fully performed. These contracts are generally assignable, unless otherwise restricted.

Progress Check - Loan Qualifications & Sources of Financing

1. In order to qualify for an FHA loan, the income requirement for a borrower is:
 - A. Minimum annual income of \$50,000
 - B. Proof of steady income for at least 2 years
 - C. Minimum annual income of \$70,000
 - D. Proof of steady income for at least 3 years
2. Regarding sources of loan financing, which does the following describe best—offers competitive rates and fees, personal service, more flexible lending standards?
 - A. Insurance companies
 - B. Commercial banks
 - C. Savings and Loan Associations
 - D. Credit unions
3. If a buyer pays \$247,000 for a house that is appraised at \$248,500 and an S&L loans him \$220,000, what is the LTV?
 - A. 83% LTV
 - B. 85% LTV
 - C. 89% LTV
 - D. 91% LTV

SECONDARY MORTGAGE MARKET, DEFAULT & MORTGAGE FRAUD

Learning Objectives

- Explain the purpose, participants, and liquidity function of the secondary mortgage market.
- Differentiate among Fannie Mae, Freddie Mac, and Ginnie Mae and their market roles.
- Explain conforming, nonconforming, and portfolio lending concepts.
- Recognize the role of automated underwriting systems in mortgage lending.
- Differentiate among judicial, nonjudicial, and strict foreclosure processes.
- Describe borrower and lender rights during default, including redemption rights and deficiency judgments.
- Explain the effect of foreclosure on lien priority and surplus sale proceeds.
- Identify alternatives to foreclosure such as deed in lieu, short sale, and REO disposition.
- Recognize the purpose of receivership clauses in income-producing property loans.
- Identify common mortgage fraud schemes, predatory lending practices, and deceptive advertising.

Secondary Mortgage Market

A network of institutions that buy and sell existing mortgage loans. While primary lenders originate loans, the secondary market purchases those loans to provide liquidity. This system benefits both parties:

- Primary lenders receive funds to make new loans
- Investors earn returns on mortgage investments

Most investors purchase mortgage-backed securities (MBS) rather than individual loans. MBS are created by pooling mortgages together, with each security representing a share of the pool.

Major participants include Fannie Mae (FNMA), Ginnie Mae (GNMA), and Freddie Mac (FHLMC).

Effects of the Mortgage Market: The secondary mortgage market provides liquidity for lenders. If the secondary market declines, less capital is available for mortgage lending, which can reduce loan availability and limit borrowers' financing options.

Function: Helps maintain the flow of mortgage funds by providing liquidity to lenders.

Intermediation: The process by which financial institutions channel funds from savers (depositors) to borrowers, such as making mortgage loans.

Disintermediation: Occurs when individuals invest directly in alternatives (such as securities) instead of depositing funds in financial institutions, reducing the funds available for lending.

Standardized Loan Requirements: Underwriting standards are guidelines used by lenders to determine a borrower's creditworthiness. These standards help establish appropriate loan amounts, terms, and interest rates, while protecting lenders from excessive risk and loss.

Here are common factors lenders evaluate when reviewing a loan application:

- ✓ Credit score and history
- ✓ Income
- ✓ Debt-to-income ratio (DTI)
- ✓ Collateral

Conforming Loans: Loans that meet the guidelines of Fannie Mae and Freddie Mac, allowing them to be sold on the secondary market.

Non-conforming Loans: Loans that do not meet these guidelines and typically cannot be sold to these agencies.

Portfolio Lenders: Lenders that retain loans in their own portfolio instead of selling them on the secondary market.

Fannie Mae (FNMA)

A government-sponsored enterprise (GSE) formally known as the Federal National Mortgage Association. It was originally created as a federal agency to purchase FHA-insured loans, and later became a shareholder-owned corporation.

Fannie Mae is regulated by the Federal Housing Finance Agency (FHFA). Both Fannie Mae and Freddie Mac are currently in conservatorship under the FHFA, which is intended to stabilize the organizations and ensure they continue to support liquidity and stability in the housing market.

Fannie Mae – Key Functions

- Does not make loans directly
- Purchases FHA, VA, and conventional loans on the secondary market
- Provides liquidity by buying and selling mortgages
- Raises funds by issuing mortgage-backed securities and other debt instruments

Fannie Mae & Freddie Mac

- Offer conventional loan programs with low down payment options (as low as 3% for qualified borrowers)
- Created by Congress as government-sponsored enterprises (GSEs)
- Provide liquidity by purchasing loans from lenders
- Promote stability and affordability in the housing market
- Support mortgage lending, especially for affordable housing

Ginnie Mae (GNMA)

A government-owned corporation within HUD, known as the Government National Mortgage Association (GNMA).

Ginnie Mae does not originate or purchase loans. Instead, it guarantees mortgage-backed securities (MBS) backed by government-insured or guaranteed loans (such as FHA and VA loans).

This guaranty increases investor confidence, allowing lenders to sell loans at better prices and generate funds to make additional mortgage loans, helping to stabilize the housing market.

Ginnie Mae (GNMA) - Key Functions

- Government-owned corporation within HUD
- Does not originate or purchase loans
- Guarantees mortgage-backed securities (MBS) backed by FHA and VA loans
- Ensures investors receive timely payment of principal and interest
- Helps increase liquidity and stability in the mortgage market

Automated Underwriting

Automated underwriting systems (AUS), such as Fannie Mae's Desktop Underwriter (DU) and Freddie Mac's Loan Product Advisor (LPA), evaluate a borrower's credit, income, and property value using algorithms.

Advantages:

- Faster loan decisions
- Consistent, standardized evaluations

Limitations:

- May not fully consider unique circumstances or compensating factors
- Some loans require manual underwriting

Default

Consequence of Default

Foreclosure: Occurs when a borrower defaults on a loan and the lender seeks to take possession of and sell the property used as collateral to satisfy the debt. The foreclosure process is governed by state law.

Foreclosures may be:

- Judicial foreclosure: Requires court action (most common)
- Non-judicial foreclosure: Allows sale without court action (in certain states)
- Strict foreclosure is rare and allowed only in a few states.

Judicial Foreclosure: A foreclosure process that requires the lender to file a lawsuit to obtain a court order to sell the property after borrower default. The lender must present evidence of the debt and default, and the borrower has an opportunity to contest the claim.

If the court rules in favor of the lender, it orders the property to be sold at public auction, with proceeds applied to the debt. The sale typically requires public notice and advertising.

Judicial foreclosures are generally lengthy and costly.

Lis Pendens: A recorded notice meaning “action pending,” indicating that a lawsuit affecting the property has been filed. It provides constructive notice to potential buyers and creditors that the property is subject to litigation. If the lender prevails, the resulting lien or judgment relates back to the date the lis pendens was recorded.

Writ of Execution: A court order issued after judgment that authorizes the sale of the property to satisfy the debt. This process may terminate the interests of the defendant and other parties, according to state law.

Non-judicial Foreclosure: If a mortgage or deed of trust contains a power of sale clause, the property may be sold without court action. Upon default, the lender or trustee provides notice to the borrower and other interested parties, then publishes a notice of sale.

During the notice period, the borrower may cure the default and stop the foreclosure. If not cured, the property is sold at public auction.

The foreclosure typically eliminates junior liens, while senior liens remain, and the buyer receives title subject to those prior interests. A lender may pursue a deficiency judgment if allowed by state law.

Deed in Lieu of Foreclosure: A voluntary transfer of property from a delinquent borrower to the lender to satisfy a defaulted loan (sometimes called a “friendly foreclosure”). Both parties must agree.

Borrowers may choose this option to avoid foreclosure costs, publicity, and potential deficiency liability. Lenders may accept it to avoid the time and expense of foreclosure.

A deed in lieu does not eliminate junior liens, which remain attached to the property. Any deficiency balance must be separately agreed upon between the borrower and lender.

Because no foreclosure sale occurs, statutory redemption rights typically do not apply.

Sheriff’s Deed: A deed issued by a court (typically through a sheriff or other official) to a purchaser after a judicial foreclosure sale.

The deed transfers the borrower’s interest in the property to the buyer. A properly conducted foreclosure sale generally eliminates junior liens, while senior liens remain attached to the property.

The purchaser receives title subject to any prior liens and encumbrances, and title is not automatically guaranteed to be marketable.

Right of Redemption

The right of a borrower to reclaim property after default by paying the required debt.

Equity of Redemption: The borrower’s right to redeem the property before the foreclosure sale by paying the full debt. This right exists in all states.

Statutory Right of Redemption: A right provided in some states that allows the borrower to redeem the property after the foreclosure sale within a specified time period.

The length of the statutory redemption period varies by state. During this time, the purchaser may receive limited rights to the property until the redemption period expires.

Strict Foreclosure: Strict foreclosure is recognized in only a small number of states. It requires that the lender provide proper notice and file a court action. The court sets a deadline for the borrower to repay the debt.

If the borrower fails to pay by the deadline, the court awards full title directly to the lender, and no foreclosure sale occurs.

If the borrower does not redeem the property within the allowed time, the borrower's equity of redemption and any statutory redemption rights are terminated.

Excess Funds

Excess Funds (Surplus Proceeds): Funds remaining after a foreclosure or trustee sale are applied to costs of sale and all lienholders in order of priority. Any remaining balance is paid to the former property owner (borrower).

Results of Foreclosure

Deficiency Judgment: A personal judgment against a borrower (and possibly other obligated parties, such as guarantors) when the foreclosure sale does not generate enough funds to satisfy the debt. Availability of deficiency judgments depends on state law.

Effect on Creditors and Lien Priority: Foreclosure proceeds are distributed according to lien priority, generally based on recording order. Property tax liens typically have priority over all other liens. Senior liens are paid first, while junior liens may be eliminated if insufficient funds remain.

When a senior lienholder forecloses, junior liens are typically eliminated from the property's title. However, the underlying debt is not extinguished, and junior lienholders may pursue other legal remedies to recover the debt.

Effect on Mortgagee (Lender): Lenders generally seek to avoid foreclosure because it can be costly, time-consuming, and may result in a financial loss if the sale proceeds do not cover the outstanding debt.

Effect on Title: Foreclosure typically eliminates junior liens, while senior liens remain on the property. Sale proceeds are distributed according to lien priority.

Short Sale: As an alternative to foreclosure, and with the lender's approval, a borrower may sell the property for less than the amount owed. The lender agrees to accept the reduced payoff and release its lien on the property.

The buyer receives title to the property, typically free of that lender's lien, but subject to any other existing liens unless they are also satisfied.

Unless prohibited by state law or waived by the lender, the borrower may still be responsible for the remaining deficiency. The lender may choose to forgive the deficiency or require repayment.

Real Estate Owned (REO): If a property does not sell at a foreclosure auction, the lender takes title to the property. The lender will then attempt to sell the property directly to recover its losses.

This repossessed property is referred to as real estate owned (REO).

Income Property Foreclosure

Receivership Clause: A provision in a mortgage on an income-producing property that allows the lender to seek a court-appointed receiver to collect rents and manage the property if the borrower defaults. The receiver uses the income to help pay operating expenses and the mortgage debt.

Mortgage Fraud

Straw Borrowers (Buyers)

A straw borrower is a person used to obtain a mortgage on behalf of another party, often to conceal the true buyer or nature of the transaction (mortgage fraud).

- Payments are often made by someone other than the borrower
- Borrower may not intend to occupy the property
- Loans often result in early payment default

Straw Borrower Red Flags

1. Unusual financial profile (income, credit, or savings inconsistencies)

2. High LTV, minimal reserves, or heavy seller concessions
3. Unrealistic occupancy (e.g., long commute, oversized home)
4. Use of gift funds with little borrower contribution
5. Non-arm's length transactions or use of power of attorney
6. Inconsistent signatures or documentation

Red Flags & Buyer Guidance

Licensees should not act as lending experts or attempt to influence loan decisions. Instead, agents should encourage buyers to work with reputable lenders and understand loan terms and risks.

Warning Signs of Predatory Lending:

- ✓ Excessive interest rates or fees
- ✓ Adjustable-rate loans/future payment increases
- ✓ Inflated appraisals (overvalued property)
- ✓ High prepayment penalties
- ✓ Little or no down payment & risky loan structures
- ✓ Requests to sign incomplete or blank documents

Predatory Lending Laws

In addition to state usury laws, federal and state regulations prohibit predatory lending, which includes unfair, deceptive, or abusive loan practices such as:

- Loan flipping (repeated refinancing with unfavorable terms)
- Excessive fees or “packing” add-on products
- Lending without regard to the borrower’s ability to repay
- Fraudulent misrepresentation of property value or borrower income
- Collusion between parties (e.g., appraisers and brokers) to inflate values

Bait and Switch Advertising

“Bait and switch” is an unlawful deceptive practice under the Federal Trade Commission Act. It occurs when a seller advertises a product without a genuine intent to sell it, in order to attract customers and then persuade them to purchase a different product.

Unfair practices include:

- Disparaging the advertised product to steer the buyer to another option
- Advertising a product that is inferior to what was represented
- Using tactics designed to discourage purchase of the advertised product
- Failing to provide the advertised product (claiming unavailability, refusing to sell, failing to deliver)

Progress Check - Secondary Mortgage Market, Default & Mortgage Fraud

1. All of the following describe a deed in lieu of foreclosure except:

- A. Eliminates redemption periods
- B. Lender must approve/accept
- C. Eliminates junior loans
- D. Borrowers do this to avoid foreclosure expenses

2. _____ is when private individuals invest their money instead of depositing it into a bank.

- A. Disintermediation
- B. Underwriting
- C. Underwriting
- D. Intermediation

3. If the tenant of the shopping mall does not pay his lease (defaults) and the owner takes the payments from the income produced by the mall the lease contract must have had a _____ clause.

- A. Acceleration
- B. Alienation
- C. Receivership
- D. Payback