Congratulations on attaining your Florida real estate license, and selecting Gold Coast as your school of choice to renew your license. Gold Coast is Florida’s leading real estate, insurance, and construction school, and has helped hundreds of thousands of students like you since 1970.

You worked hard to get your license. Florida law requires that you complete the 45-hour course and pay your renewal fees prior to your license expiration date. Failure to do so will render your license void. Don’t take that chance. We highly recommend that you complete the 45-hour course well in advance of your license renewal date.

While your pre-license sales associate course focused heavily on passing the end of course and state exams, the 45-hour post-license course is intended to be more of an application oriented course. You should recognize many of the concepts from your pre-license course, but this course will cover the concepts from an application or real life point of view.

This course does not require a state examination, but it does require an end-of-course examination. All of the concepts covered on your end-of-course examination are covered throughout the practice questions in the course. Please take the time to read the book and answer all of the questions. You must obtain a passing grade of 75% on the end-of-course exam to complete the course.

This book is intended to serve as an educational resource. It is not intended as a substitute or replacement for the rules or statutes of the state of Florida. The authors do not intend to give legal or accounting advice. If you are involved in a situation or transaction that requires a legal or accounting opinion, we recommend that you seek the advice of a properly licensed attorney, accountant, or professional.

This edition of the book is the culmination of the efforts of many people over a number of years. Gold Coast would like to recognize and thank the following people for their input, hard work, and dedication: Wayne Hasse, Debby Hancock, Toni Golden, Melodee Ashby, Tim Haines, Jack Bennett, Barb Byrne, and Mike Byrne.

I want to personally thank you for choosing Gold Coast and wish you the best with your real estate career. If you have any suggestions to improve this material or course, I would like to hear from you. Please contact me at john@goldcoastschools.com. Feedback from previous students is invaluable for future students.

Thank you,

John Greer, EdD
Director, Gold Coast School of Real Estate
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CHAPTER 1

REAL ESTATE AS A CAREER

OVERVIEW
Real estate is a truly dynamic industry with numerous opportunities and professional specialties for the practitioner. “Under all is the land,” says the preamble to the REALTOR® code of ethics. It’s easy for real estate professionals to forget that they deal in what is seen by most people as one of the most valuable commodities on earth - land upon which all else is built. Real estate professionals are privileged to help people realize the true American dream of home ownership on a daily basis.

The opportunities in real estate are endless and the future looks bright. Not only does Florida have a booming population to work with, but people from all over the world come to Florida daily to buy and sell real estate. As licensed real estate professionals, we are in an enviable position to benefit directly from this dynamic real estate market. Everyone needs to live somewhere, work somewhere, and shop somewhere. The potential for success in Florida real estate is truly unlimited.

This chapter will provide information about the vast array of specializations available in this field, discuss the role that education and technology play in a real estate career, and offer tips for planning your real estate career.

OBJECTIVES
After completing this chapter, you should be able to do all of the following:

- Identify various specializations available to real estate professionals
- Know the definition for a residential sales transaction
- Identify types of professional organizations available to real estate licensees
- Know the purpose of the NAR Code of Ethics
- Explain the skills necessary for a successful real estate career
- Know the key technological tools for a successful business
- Identify important elements in planning your business

SELECTING A SPECIALIZATION WITHIN THE REAL ESTATE PROFESSION

The real estate profession offers a wide variety of choices of activities in which licensees may specialize. These choices are either directly related to a specific type of real estate or relate to support services that real estate professionals provide to the general public. The following are some examples of specialization that illustrate the wide variety of opportunities in the real estate profession.

Residential Sales or Rentals

Residential sales or rentals can provide a rewarding career for new or experienced real estate professionals. The overwhelming majority of real estate licensees are involved in residential sales.

Many licensees will concentrate on one type or style of property or on one particular neighborhood, a practice called farming. Finding and specializing in a particular neighborhood or type of property is considered one of the best ways to succeed in residential sales.
A *residential transaction* is defined in F.S. 475.278(5)(a) as the sale of any:

- Improved residential property of four units or fewer, including condominium units;
- Unimproved property intended for four units or fewer;
- Agricultural properties of ten acres or less;
- Leases with options to purchase all or a portion of improved property of four or fewer residential units; and
- Dispositions of business interests for property of four or fewer residential units.

**Commercial Sales or Leasing**

Commercial properties include apartment buildings, strip malls, office space, and shopping centers. Real estate licensees who specialize in commercial real estate must have extensive knowledge of business property. They must be capable of analyzing the past and future potential income derived from investment property.

Commercial real estate practitioners must also have a basic knowledge of tax laws that affect income earned from commercial property as well as the tax consequences of buying and selling investment property.

**Industrial Sales or Leasing**

Industrial properties include warehouses and manufacturing facilities. Industrial sales and leasing generally involve user/owners, rather than investors. Industrial real estate practitioners seek to locate properties that meet the future owner’s requirements. Knowledge concerning government regulations of land use, environmental considerations, transportation, labor costs, and utility charges are all important when attempting to meet the requirements of such purchasers.

**Timeshare/Vacation Ownership Sales**

A timeshare property is a condominium unit that is subdivided into ownership time periods. Timeshare ownership includes the right to use the property for some period-of-time, sometimes referred to as *interval ownership*. With numerous destination and vacation properties in Florida, a large number of licensees are employed in the area of timeshare or vacation ownership sales. Sales leads in this area are typically provided to the associate by the employer.

**Agricultural Sales**

As the name implies, agricultural properties are generally rural areas used for growing of crops or the rearing of animals to provide food or other products. Two common characteristics of agricultural sales are large tracts of land and significant sums of money. Real estate professionals involved in agricultural sales must be able to analyze the profitability of current agricultural uses and estimate the potential of properties under consideration.

**Property Management**

Managing income-producing properties for owners has grown over the years and has become a major service offered by real estate professionals. Owners who buy income property as investments and depend on professionals to manage them are called *absentee owners.*
Property management differs from simply being a rental agent. A rental agent merely finds tenants for properties and collects a fee for the service, but usually does not manage the property.

A property manager’s responsibilities include:

- Locating tenants;
- Collecting rents;
- Handling the payment of taxes, insurance, and other operating expenses;
- Maintaining records; and
- Scheduling maintenance.

Ultimately, the function of good property management is to maximize the profitability of the investment for the owner.

Typically, compensation to property managers is based on a percentage of the rents collected from tenants. Percentage compensation is beneficial to both the owner and the manager.

**Business Brokerage**

A real estate professional who specializes in business brokerage, or the listing and sale of businesses, must be able to estimate the value of an entire business, which is being offered for sale or purchase, separate from the value of any building or real estate. Valuing a business requires an analysis of financial statements and balance sheets. The value of a business, called *going concern value*, includes its income, tangible and intangible assets, and goodwill, in addition to the value of the real property. *Goodwill* is the value of the name or reputation of the business in the marketplace. If the sale of a business involves the transfer of ownership of shares of stock, a real estate licensee would also be required to have a securities license.

**Appraising**

Appraising is the process of developing an opinion of value of real property. An appraiser conducts an independent, impartial, objective, and defensible analysis based on research and data pertaining to the value of a specified real property. Appraisal fees are based on the time, effort, and expense involved for completion of the assignment, not on the value of the property.

An appraisal may be required in a variety of situations. Lenders may require an appraisal to determine whether the value of property being used as collateral for a loan is adequate. Appraisals may also be required in connection with federal income tax claims, federal estate taxes, protesting real estate tax assessments, eminent domain, investment planning, insurance claims, and in many other circumstances.

An appraisal that is used in a federally related transaction must be performed by an appraiser who is registered, licensed, or certified under Part II of F.S. 475, which is administered by the Florida Real Estate Appraisal Board (FREAB). A federally related transaction is one in which a loan is made by a federally regulated lending institution that uses real property. All appraisals, whether performed by a licensed appraiser or a real estate licensee, must be developed and reported in conformity with the Uniform Standards of Professional Appraisal Practice (USPAP).

Real estate licensees typically prepare a comparative market analysis, or CMA, which is a value estimate based on recent sales or listings of similar properties in the same neighborhood. A CMA uses many of the concepts used in an appraisal. However, a CMA is not an appraisal. Real estate licensees may perform an appraisal under the real estate license law if the appraisal will not be used in a federally regulated transaction. Refer to Chapter 3 for information on selecting comparable properties.
Counseling

Real estate counselors give advice to consumers about property. They are the experts, whom others seek when they want answers to real estate questions about such things as avoiding mortgage foreclosure, dealing with predatory lending, handling rental default, finding suitable income opportunities, or getting a reverse mortgage.

Counseling is a highly specialized service and requires a greater level of knowledge and experience than any other facet of the real estate profession. Counselors must not only have a superior knowledge of real estate investment, but must also have detailed knowledge of alternative investments and strategies.

PROFESSIONAL ORGANIZATIONS

Belonging to a trade association can add credibility to you as a real estate professional, as well as provide you with a host of benefits. In addition to educational opportunities, these organizations offer access to tools such as downloadable forms, opportunities to network with other real estate professionals, and, in some cases, access to an online Multiple Listing Service (MLS) system.

Professional organizations are also the first place members look to find the latest changes and trends in the real estate industry. Associations exist at the national, state, and local levels.

National Association of REALTORS® (NAR)

The National Association of REALTORS® (NAR) is the largest and most prestigious real estate organization in the world. NAR works for legislation that is favorable to the industry and it enforces professional standards of conduct through its Code of Ethics. Only members of NAR and its state divisions may use the trademark of REALTOR® when presenting themselves to the public.

NAR requires its members to take a mandatory ethics course every four years. Failure to take the course results in suspension from the organization until the training has been completed.

The core purpose of the NAR is to help its members become more profitable and successful. It offers extensive information and market studies concerning the real estate industry and is the largest resource for education, technology, real estate and politics, member benefits, networking and consumer research, just to name a few.

For more information on NAR, please visit www.realtor.org.

Florida Association of REALTORS® (FAR)

The Florida Association of REALTORS® (FAR) is the largest trade association in the state. FAR does all its business as Florida REALTORS®.

Members can take advantage of a host of membership benefits, including business contacts, networking opportunities, educational offerings, research and legislative representation, discount programs, online forms, and technology services.

Florida REALTORS® is one of the number one resources for support and information in a licensee’s real estate business. This organization offers complete access to all of
the necessary real estate forms, help with technology, legal advice, Florida market
studies, educational tools and services, and much more.

For more information on FAR, please visit www.floridarealtors.org.

Local Association of REALTORS®

Many real estate licensees choose to join local boards or associations of
REALTORS®. Joining a local association also gives the licensee membership in FAR, as
well as NAR. If a broker is a member, all sales associates must also join.
Local REALTOR® associations provide access to the multiple listing service (MLS),
which is a major tool in the success of a real estate business. In addition, it affords
unlimited networking possibilities, specialty education, local market research,
technology, websites, school information, code of ethics enforcement and arbitration.
These are just some of the many benefits of belonging to the local REALTOR®
Association.

CODE OF ETHICS

High ethical standards in real estate are very important – more important than in
some other transaction in which the consumer may be more familiar with the service
being performed. It’s critical that real estate licensees act in the best interest of both the
client and any third parties to a transaction.

Ethics are not the same as laws. Laws are put in place to maintain order in society
by setting minimum standards for acceptable behavior with penalties for noncompliance.
Ethics are standards of moral conduct with respect to what is considered right and wrong
with certain actions. An action can be legal, but unethical. Ethics tend to hold people
accountable to higher standards than laws. Good ethical practices have to do with
trustworthiness, honesty, and competence.

The first Code of Ethics was adopted by the National Association of Real Estate
Exchanges in 1913 to establish professional standards of conduct in the real estate
profession. The National Association of Real Estate Exchanges was renamed as the
National Association of Real Estate Boards (NAREB) in 1916 and then became the
National Association of REALTORS® (NAR) in 1972.

REALTORS® were among the first of professions to adopt a professional code of
ethics for their business practices after those of medicine, engineering, and law. The
code is a commitment to professionalism.

NAR members follow a very strict code of ethics. The REALTOR® Code of Ethics
holds members of local Associations of REALTORS® to even higher standards than the
law requires. The formal Code of Ethics and Standards of Practice set forth by NAR calls
for professionals to observe the “Golden Rule” (do to others as you would have others
do to you) and to conduct themselves and their real estate business in accordance with
certain standards of practice. These standards of practice are contained in seventeen
articles that spell out licensee’s duties to the clients, public, and other real estate
licensees. They encompass all real estate-related activities and transactions whether
conducted in person, electronically, or through any other means.

To view the Code of Ethics, please visit the NAR Web site:
www.realtor.org/code-of-ethics
A few of these duties are summarized below. Refer to the Code of Ethics\textsuperscript{1} for details.

1. Duties to clients and customers (Articles 1 through 9)
   - Do not deliberately provide misleading information
   - Represent both parties in the same transaction only after full disclosure and with informed consent of both parties
   - Submit all offers and counteroffers objectively and quickly
   - Maintain the obligation to preserve confidential information during and following the termination of the client relationship
   - Avoid exaggeration, misrepresentation, or concealment of pertinent facts relating to the property or the transaction
   - Cooperate with other brokers except when cooperation is not in the client’s best interest
   - Inform sellers or purchasers of the licensee’s own interest in a property or any suggested product or service
   - Do not accept any commission, rebate, or profit on expenditures made for the client without the client’s knowledge and consent
   - Do not accept compensation from more than one party, even if permitted by law, without disclosure and informed consent of all parties
   - Keep a special account in an appropriate financial institution, separate from personal funds for monies related to real estate transactions
   - Provide copies of all agreements to each party

2. Duties to the public in general (Articles 10 through 14)
   - Provide equal, non-discriminatory services to all persons
   - Do not volunteer information regarding the racial, religious, or ethnic composition of any neighborhood
   - When not involved in a transaction, a licensee may provide necessary demographic information related to a property that is obtained from a disclosed, recognized, reliable, independent and impartial source
   - Refrain from providing professional services outside the licensee’s field of expertise
   - Be honest and truthful in real estate communications, advertising, marketing, and other representations
   - Clearly identify the licensee’s status as a real estate professional in all forms of communication and advertising
   - Do not participate in activities that might constitute the practice of law

3. Duties to other real estate licensees (Articles 15 through 17)
   - Do not make false or misleading statements about other real estate professionals, their businesses, or their business practices
   - Do not take any action inconsistent with exclusive representation or other relationship agreements that other licensees have with clients
   - Mediate or arbitrate any disputes with other licensees

REALTORS\textsuperscript{©} engage in many specialty areas and may be subject to additional codes and canons of those fields, such as legal ethics and the Uniform Standards of Professional Appraisal Practice (USPAP). Regardless of their real estate specialties or fields of practice, all REALTORS\textsuperscript{©} are bound by the Code of Ethics of the National Association of REALTORS\textsuperscript{©}.

\textsuperscript{1} Code of Ethics and Standards of Practice of the National Association of REALTORS\textsuperscript{©}, Effective January 1, 2014
PROFESSIONAL DESIGNATIONS AND CERTIFICATIONS

The education never stops for the true professional. Even if you have been in the real estate business for many years, you need to continue your real estate education to ensure long-term success. The constant quest to improve your presentation skills, prospecting skills, marketing skills, and understanding of technology, not to mention keeping up-to-date on changes in the law, will allow you to grow your business and achieve your business goals over the long term.

In the beginning, it is critical to learn as much as possible about the industry. This course is designed to help you to understand the correlation between training and the success of your business, but it is only the beginning. You should check with local real estate schools or REALTOR® associations to find out about any educational courses they offer. Taking advantage of any education and training, as often as possible, is the key to success in the real estate industry.

There are numerous professional designations offered through the NAR and the FAR. You should review these designations to see which ones may be appropriate for you to pursue. The process of attaining a designation may take several years in some cases, but it will be well worth it. Start now and continue working on them as your business grows. These designations will increase your credibility in the marketplace and provide another tool to separate you from the competition.

Designations and certifications from the NAR website are shown in the tables below. This list is only a sampling of designations and certifications that are available from a variety of sources.

For more information, please visit the NAR Web site: www.realtor.org/designations-and-certifications

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<th>Certification</th>
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<tr>
<td>At Home with Diversity</td>
<td>AHWD®</td>
<td>Learn to work effectively with, and within today’s diverse real estate market. The AHWD® certification teaches you how to conduct your business with sensitivity to all client profiles and build a business plan to serve them successfully.</td>
<td>NAR 1-800-874-6500  <a href="mailto:ahwd@realtors.org">ahwd@realtors.org</a></td>
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<td>Broker Price Opinion Resource</td>
<td>BPOR</td>
<td>The BPOR certification provides REALTORS® with knowledge and skills to perform accurate and professional broker price opinions (BPOs) and comparative market analyses (CMAs), while reducing risk and increasing opportunities.</td>
<td>NAR 1-800-874-6500  <a href="mailto:bpor@realtors.org">bpor@realtors.org</a></td>
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<td>e-PRO®</td>
<td>e-PRO®</td>
<td>This certification teaches you to use cutting-edge technologies and digital initiatives to link up with today’s savvy real estate consumer.</td>
<td>NAR/e-PRO® (877) 397-3132  <a href="mailto:epro@realtors.org">epro@realtors.org</a></td>
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<tr>
<td>Military Relocation Professional</td>
<td>MRP</td>
<td>The MRP certification focuses on educating real estate professionals about working with current and former military service members to find housing solutions that best suit their needs and take full advantage of military benefits and support.</td>
<td>Real Estate Buyer’s Agent Council (REBAC) 1-888-648-8321  <a href="mailto:MRP@realtors.org">MRP@realtors.org</a></td>
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<tr>
<td>Resort and Second-Home Property Specialist</td>
<td>RSPS</td>
<td>This certification is designed for REALTORS® who facilitate the buying, selling, or management of properties for investment, development, retirement, or second homes in a resort, recreational, and/or vacation destination.</td>
<td>NAR 1-800-874-6500  <a href="mailto:resort@realtors.org">resort@realtors.org</a></td>
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<tr>
<td>Short Sales and Foreclosure Resource</td>
<td>SFR®</td>
<td>The SFR® certification teaches real estate professionals to work with distressed sellers and the finance, tax, and legal professionals who can help them, qualify sellers for short sales, develop a short sale package, negotiate with lenders, safeguard your commission, limit risk, and protect buyers.</td>
<td>NAR 1-877-510-7855  <a href="mailto:sfr@realtors.org">sfr@realtors.org</a></td>
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<td>Accredited Buyer Representative</td>
<td>ABR®  This designation is designed for real estate buyer agents who focus</td>
<td>Real Estate Buyer's Agent Council (REBAC) 1-800-648-6224 <a href="mailto:rebac@realtors.org">rebac@realtors.org</a></td>
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<td>on working directly with buyers at every stage of the home-buying process.</td>
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<td>Accredited Land Consultant</td>
<td>ALCsm  The esteemed ALCsm are the most trusted knowledgeable, experienced,</td>
<td>REALTORS® Land Institute (RLI) 1-800-441-5263 <a href="mailto:rli@realtors.org">rli@realtors.org</a></td>
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<td>and highest-producing experts in all segments of land. Conferred by the</td>
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<td>REALTORS® Land Institute, the designation requires successful completion</td>
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<td>experience level, and adherence to an honorable Code of Conduct.</td>
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<td>Certified Commercial Investment</td>
<td>CCIMsm  The CCIMsm designation is commercial real estate's global standard</td>
<td>CCIM Institute 1-800-621-7027 <a href="http://www.CCIM.com">www.CCIM.com</a></td>
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<td>Member</td>
<td>for professional achievement, earned through an extensive curriculum of</td>
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<td>200 classroom hours and professional experiential requirements.</td>
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<td>Certified International</td>
<td>CIPS®  Instantly align yourself with the best in international real</td>
<td>NAR 1-800-874-6500 <a href="mailto:CIPS@realtors.org">CIPS@realtors.org</a></td>
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<td>Property Specialist</td>
<td>estate by earning the CIPS® designation. The program includes five full</td>
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<td>days of study focusing on the critical aspects of international real</td>
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<td>estate transactions, and an influential network of 2,000 professionals</td>
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<td>who turn to each other first when looking for referral partners.</td>
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<td>Certified Property Manager</td>
<td>CPM®  CPM® designees are recognized as experts in real estate management.</td>
<td>Institute of Real Estate Management (IREM) 1-800-837-0706</td>
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<td>Holding this designation demonstrates expertise and integrity to employers,</td>
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<td>owners, and investors.</td>
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<td>Certified Real Estate</td>
<td>CRBsm  The CRBsm is one of the most respected and relevant designations</td>
<td>CRB Council 1-800-621-8738 <a href="mailto:info@crb.com">info@crb.com</a></td>
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<td>Brokerage Manager</td>
<td>awarded in real estate business management. It is awarded to REALTORS®</td>
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<td>who have completed advanced educational and professional requirements.</td>
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<td>CRBsm designees are better positioned to streamline operations, integrate</td>
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<td>new technology, and apply new trends and business strategies.</td>
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<td>Certified Residential Specialist</td>
<td>CRS®  The CRS® designation is the highest credential awarded to</td>
<td>Council of Residential Specialists (CRS) 1-800-462-8841 <a href="http://www.crs.com">www.crs.com</a></td>
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<td>®</td>
<td>residential sales agents, managers, and brokers. On average, CRS® designees</td>
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<td>earn nearly three times more in income, transactions, and gross sales</td>
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<td>than non-designee REALTORS®.</td>
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<td>Counselor of Real Estate®</td>
<td>CRE®  The Counselors of Real Estate® is an international group of</td>
<td>The Counselors of Real Estate® (312) 329-8427 <a href="mailto:info@cre.org">info@cre.org</a></td>
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<td>recognized professionals who provide seasoned, expert, objective advice</td>
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<td>on real property and land-related matters. Only 1,100 practitioners</td>
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<td>throughout the world carry the CRE® designation. Membership is by invitation only.</td>
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<td>General Accredited Appraiser</td>
<td>GAAsm  For general appraisers, this designation is awarded to those whose</td>
<td>NAR 1-800-874-6500 <a href="mailto:appraisal@realtors.org">appraisal@realtors.org</a></td>
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<td>whose education and experience exceed state appraisal certification</td>
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<td>requirements and is supported by the National Association of REALTORS®.</td>
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<td>NAR’s Green Designation</td>
<td>GREEN  Through NAR’s Green Designation, the Green Resource Council</td>
<td>The Green Resource Council 1-800-498-9422 <a href="mailto:greendesignation@realtors.org">greendesignation@realtors.org</a></td>
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<td>provides ongoing education, resources, and tools so that real estate</td>
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<td>practitioners can successfully seek out, understand, and market properties</td>
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<td>Graduate, REALTOR® Institute</td>
<td>GRII®  REALTORS® with the GRII® designation have in-depth training in</td>
<td>NAR 1-800-874-6500 <a href="mailto:gr@realtors.org">gr@realtors.org</a></td>
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<td>legal and regulatory issues, technology, professional standards, and the</td>
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REQUIRED SKILLS FOR THE REAL ESTATE PROFESSIONAL

Today’s real estate market is extremely competitive and complex; it presents unexpected challenges and opportunities for the real estate professional. Perhaps the most important factor in your success in real estate is skills training. It is imperative that you obtain the skills and knowledge necessary to compete successfully in the real estate market.

The real estate professional is expected to have expert knowledge in the following three areas: valuation, marketing, and property transfer.

- **Valuation.** Real estate licensees must be able to discern important differences between properties and know how to translate those differences into value. Licensees must be educated with the skills, procedures, and tools to perform a comparative market analysis.

- **Marketing.** Real estate markets are constantly changing. Licensees must have an understanding of the tools and technologies available to market a property.
• **Property transfer.** Conveying ownership or rights in property is a complex process. There are many laws, documents, disclosures, and technicalities involved in completing a real estate transaction. Deeds, mortgages, surveys, appraisals, contracts, title insurance, floodplains, and zoning and building codes are some of the components that the licensee is expected to handle. It is important that licensees have the procedural knowledge and understanding of the various forms, tools, and processes for transacting real estate.

There are three basic categories of knowledge and skills necessary to build the expert knowledge you need for your business: procedural knowledge, marketing skills, and product knowledge. The successful professional must be proficient in all of them. Additionally, today’s real estate professional must be able to make good use of current technology in all aspects of their profession.

**Procedural Skills**

We cannot overstate the need for procedural knowledge. A sales associate should never enter the market place without the proper understanding of the information required to perform his or her duties as a licensed real estate professional. For example, what good does it do to work with a buyer if you find an appropriate property but then you do not know how to write an offer? The responsibility for completing the contract is yours.

Areas of procedural knowledge include:

- Listing contract
- Disclosures
- Comparative market analysis (CMA) preparation
- Seller net sheet
- Buyer qualification / financial
- Purchase and sale contracts
- Closing Disclosure
- Investment analysis
- Foreclosure process

**Marketing Skills**

Marketing skills are critical for any successful professional. Where business comes from and how to get it are necessary answers for any licensee. This course will cover some of the marketing skills required, but you will likely need additional training, which you can find through a real estate school, your sponsoring broker, the National Association of REALTORS® (NAR), the Florida Association of REALTORS® (FAR), and other local REALTOR® associations. Some of the marketing topics that you will find particularly helpful include:

- Self-marketing (business planning)
- Prospecting for listings
- Building and making a listing presentation
- Servicing the listing
- Qualifying the buyer/needs/motivation
- Showing a property
- Closing the transaction
Product Knowledge

As a real estate professional, you are expected to know and completely understand the market in which you work. The customers who retain your services expect you to provide this knowledge in an effort to meet their real estate needs. Specific product knowledge includes:

- Market statistics
- Available inventory
- Distressed properties

TECHNOLOGY

The way real estate is practiced has changed drastically in the last ten years. Technology has enabled licensees to reach more people, do more business, and close more transactions than ever before. Today’s customers expect and demand that real estate professionals be readily accessible and proficient in the use of technology. Real estate is still a people business, but the way professionals conduct the business is largely Internet-based and technology-oriented. Customers expect a quick response to their inquiries, whether by e-mail, cell phone, or text message.

At a very minimum, you need access to and must be proficient in, the use of the following:

- The multiple listing service (MLS) system
- A computer, laptop, or tablet
- Forms programs
- Word processing software programs
- Contact management programs
- The Internet
- E-mail programs
- A cell phone
- A digital camera

Multiple Listing Service (MLS) System

The MLS is one of the most important resources for the success of your real estate business. It’s extremely important that you be completely knowledgeable and proficient in the use of the MLS and all that it has to offer. This training is readily available through the local REALTOR® Association and it’s an absolute necessity for your success.

The MLS affords you the opportunity to market your listings to thousands of local REALTORS® and thousands of REALTORS® statewide. This is in addition to marketing properties to potential buyers and other REALTORS® around the world. The MLS also provides a detailed database of properties of all kinds, which are available for sale or lease on a local and state level. As if this was not enough, the MLS is the go to source for market data and statistics. Market statistics are available in all market areas at the click of a button. It’s extremely important that you be up-to-date and knowledgeable in local market conditions. Today’s clients demand it.

The MLS provides extensive marketing tools to support you and your real estate business. Professionally designed listing presentations and buyer presentations are waiting for you to personalize and customize them to suit your business needs. Today’s buyers and sellers are far more sophisticated than in years past. They require detailed information concerning properties and market conditions. It’s imperative that you have knowledge of and access to the information required by your clients. Think about it. How
often do consumers who need a product or service call for assistance but receive only lip
service or are put off entirely? In those cases, consumers become extremely frustrated
and call someone else. Conversely, what happens when a consumer calls someone who
is a true professional; one who is courteous and has all the information the consumer
requires? That consumer is often ready to do business. If you are a professional,
courteous service provider, you will be ready to do business when those consumers
make that call.

Forms Programs

Forms programs allow you to provide clear, precise, and professionally prepared real
estate forms. On very rare occasions, you may be forced to write a contract on the hood
of the car, but by-and-large those days are long gone. Today, licensees prepare all real
estate forms at the computer and send them via e-mail or fax to all of the interested
parties. Not only can you prepare the forms and send them directly from the forms
program, but you can also store them for later use.

You can download several excellent form programs to your computer. In addition, all
members of Florida REALTORS® have access to an excellent forms program called
Forms Simplicity.

The most commonly used forms are:

- Sales and purchase contract with addendums
- Brokerage relationship disclosures
- Listing contracts
- Lead paint notices
- Seller’s property disclosure
- Leases and intent to enter into a lease
- Commission agreements

At the very least, licensees need to know what forms are available online, how to
prepare them, how to add and attach addendums, how to scan and e-mail them, and
how to save them for future use.

Remember, the forms you prepare are seen by a vast number of people, including
the other real estate professionals for the transaction, the buyer, the seller, the
attorneys, the mortgage loan originator, and the title company, just to name a few. All of
them will form an opinion of your level of professionalism based on how you prepared
those real estate forms.

Word Processing

Word processing is an indispensable part of any real estate business, one that many
professionals take for granted. There are numerous valuable applications, such as
Microsoft Word, that you can use in your daily business activities. You can do all of your
real estate correspondence, marketing pieces, and organization of information, projects
and ideas through a good word processor. One of the most useful applications is mail
merge, which gives you the ability to merge databases with real estate correspondence
to create easy, efficient, and targeted prospecting pieces. The program also allows you
to create a separate folder for each client, which you can easily access for future
reference.
**Contact Management Software**

As a successful real estate professional, you will need to maintain and access vast amounts of information about the people with whom you work. Names, phone numbers, e-mail addresses, websites, fax numbers, mailing addresses, and so on are all part of the data you will collect about your contacts. Contact management software affords users the opportunity to store this information in vast quantities and retrieve it at will. No more Post-it notes or scraps of paper that you can easily lose or misplace. All the important information will be in one location and easily accessible when you need it.

Contact management software is crucial in maintaining a prospecting database. Without the proper use of contact management software, your chances of success in the real estate business will be severely hampered. Some popular contact management software programs include Top Producer and ACT Contact Management.

**The Internet**

Almost everyone uses the Internet today, including real estate licensees, buyers, sellers, investors, attorneys, accountants, bankers, and educators. The Internet is an indispensable part of real estate today. You do the vast majority of your marketing, prospecting, and communicating via the Internet, and it’s still growing. The Internet has made it possible for licensees to reach more people, do more business, and close more transactions than ever before. We cannot overstate the power of the Internet. More than 85% of all buyers start their search for a new home on the Internet.

Internet Explorer is the most widely used browser, but there are others like Firefox, Safari, and Google Chrome; more are likely to come on the scene as technology changes. There are also numerous Internet service providers (ISPs), such as AT&T, Comcast, and Verizon.

**E-mail**

Today, we do more and more of our communication by e-mail. In fact, it’s the preferred method of communication by many customers. As with phone calls, customers expect a quick response to their e-mail correspondence, anything less is unacceptable. For the real estate professional, e-mail is a necessary tool.

To ensure your success, become proficient in the following e-mail tasks:

- Create an address book
- Send an email with attachments
- Reply to an email
- Forward an email
- Sort, save, and file emails for future reference and follow up

According to the 2010 NAR member profile, e-mail is the preferred method of communication with customers for 92% of all REALTORS®. Popular e-mail programs include Microsoft Outlook, Outlook Express, and various free web mail services such as Gmail and Yahoo.

**Cell phone**

In the real estate business, the cell phone is indispensable. It enables you to maintain immediate contact with all of your customers. As a real estate professional, you may have found that the cell phone is a critical tool that allows you to return phone calls, check e-mails, access the Internet, take photos, and store data at a moment’s notice. It’s
the link between you and your real estate business when you are on the go. Today, customers expect a quick response from their real estate professional.

**Digital Camera**

The digital camera plays a critical role in real estate marketing. It’s essential for listing agents to market and promote their properties properly. It’s said that one picture speaks a thousand words. This is certainly true in real estate. The digital camera allows you to take large numbers of color photos of your newly listed property and upload them to the Internet, MLS, property flyers, brochures, and direct mail pieces. Consumers view listings with more than six photos on the Internet 300% more than properties with one or no pictures. The MLS allows agents to upload 16 or more color pictures per listing.

**Accessibility**

Wireless access is another critical component of communications. Many tablet-type devices have the option of connecting to a network as a paid service, just like a cell phone. Air cards are also available for laptops. Some providers may offer “hotspot” access, which turns a cell phone into a wireless access point. This creates a wireless network where none may otherwise be available. In the future, access providers will no doubt offer an even greater array of options for staying connected. True professionals will ensure that they have Wi-Fi access and will not rely on using the client or customer’s access.

**PLANNING YOUR BUSINESS**

**Selecting an Employer**

Newly licensed sales associates are often confused as to what they should look for in an employer. Typically, the first question an associate asks is “What is my commission rate?” Choosing an employer requires far more information than simply looking at the commission rate. Each real estate professional needs to make this decision as an individual. What is right for one associate may not be right for another. To help clarify this important decision, below are some questions associates can and should ask when selecting an employer.

- What is your in-house training program?
- Do you pay for outside seminars or local training?
- Do you typically hire new associates?
- Do you provide a mentor program and/or office assistance for the licensees?
- Does the firm have a selection of books, audios, videos, and CDs on hand for associates to use?
- What is your commission plan? How does it work at year-end (i.e. rollbacks)?
- At what percentage can associates take listings?
- Do you charge transaction fees?
- Do you have an E&O (errors and omissions) policy? Who pays for it? How much is the coverage?
- What marketing does the company do? What marketing am I permitted to do on my own? Who pays for marketing? Who pays for direct mailing (postage and printing)?
- Does the company have a website? Are MLS listings on the site? Can a sales associate have his or her own site? What company information must be on an individual associate’s site?
• What are the desk fees, phone usage fees, long distance fees, copy fees?
• Who pays for yard signs? Business cards?
• Do you have a warranty company?
• Do you have an in-house attorney?
• Do you have an in-house mortgage company? Will I be required to use a particular mortgage company?
• What happens if I sell my own home?
• If I leave the company, what happens to my listings?
• If the transaction offers a bonus, how is it split?
• Are there any other fees that we have not discussed?
• Are there areas where your policies differ from most other brokers?

Creating a Mission Statement

A mission statement is a description of a desired outcome that excites, motivates, and helps you to create a mental picture of your business goal.

Mission Statement Example:

“To be the educated choice for real estate consumers and the provider of real estate knowledge, marketing, and professional services that are essential to my client’s success and profitability in their real estate transactions.”

Create your own mission statement in the space provided below.

Setting Goals

In order to run a successful business, it is important to set goals and develop a business plan to achieve those goals. Setting realistic and attainable goals is a high priority. It is a good idea to identify your short-term, intermediate, and long-term goals.

• **Short-term goals.** Ask this question: What specific things will I do in my first year?

  For example:

  o How many contacts will I make per week?
  o How many listings will I get each month?
  o What training sessions will I attend?

• **Intermediate goals.** Ask this question: How do I see my career progressing from year two to year five?

• **Long-term goals.** Ask this question: Where do I want my career to be in five to ten years from now?
When setting your goals, you may find the following tips useful:

- **Make your goals definite and measurable.** It’s critical for your goals to be both realistic and attainable. For example, decide that you will get “three new listings a month,” rather than that you will get “more listings.”

- **Put your goals in writing.** It’s much easier for you to prioritize your tasks and evaluate your progress if your goals are in writing.

- **Realize that goals are not rigid.** As you move through your career, your talents and interests may change, so you can adjust your goals to match those changes.

It’s also important to set daily and weekly work objectives. These objectives should be steps that lead directly to meeting your short-term goals.

### Daily Activities

You should devote some of each day to these and other similar activities.

- Return phone calls
- Develop new leads
- Answer mail and e-mail
- Review new listings
- Check on sold properties
- Call potential clients*
- Prepare for listing presentations
- Show property, if applicable

* Remember to consult and comply with the “National Do Not Call Registry” and the Florida “Do Not Call” guidelines before making any solicitation calls.

### Weekly Activities

Remember the following specific activities, which will contribute greatly to your success as a salesperson.

- Develop your **sphere of influence** by letting them know you are a real estate agent. Your sphere of influence is comprised of everyone you know and everyone who knows you. It’s generally believed that the average adult knows about 400 people by name. If each of these 400 people also has a sphere of 400 people, then that’s 160,000 people you could conceivably have a chance to work with! Actually, there are three levels, or circles, of influence. They are listed below.

  - **Core circle.** The core circle level includes your family (spouse, parents, aunts, uncles, cousins, nieces, nephews, grandparents, etc.), work team, and your boss. You interact with individuals from your core circle many times every day. This level can also include an inner core of people with whom you have partnered and who understand and share your goals.
- **Inner circle.** The inner circle includes your work acquaintances, personal friends, vendors, past colleagues, neighbors, church friends, etc. These resources are often untapped and you can easily call upon them. This is a broad group of people that know you.

- **Outer circle.** The outer circle is made up of people you don’t see regularly; people whose names you may or may not recognize but to whom you could be introduced, such as community members from local organizations, members of your local chamber of commerce. These are people you could approach but probably have not. This is fertile ground for cultivation.

- Preview your company’s listings to become more familiar with the amenities. This will increase your expertise.

- Spend time learning about other company’s listings in your geographic area or your area of specialty.

- Familiarize yourself with your office’s policies and procedures manual. If your employer broker has one, it will probably include information on confidentiality expectations, use of personal assistants, general office procedures, advertising requirements, how to work with clients, what records licensees are required to keep, and how to handle both in-office and third party disputes.

- Practice filling out the forms your company uses so you will not falter when working with clients.

- Learn how to use all of the machines at your firm (e.g., fax machine, copy machine, voice mail system, etc.).

- Become proficient in using the computer, especially for e-mail and MLS searches.

- Learn what you need to know about real property taxes and the tax benefits of home ownership.

- Make sure you have the proper equipment for success (e.g., business cards, a cell phone, and a clean, comfortable car).

- Equip your car with important items, such as maps or GPS, for sale signs, extra pens and forms, a tape measure, a flashlight, small tools, calculator, digital camera, and chargers for all devices.

- Read professional trade magazines and newspapers published by real estate groups.

- Attend business-related courses or seminars.

- Research real estate topics on the Internet.

To start, keep your plan simple and basic. As your business grows and progresses, your business plan should become more detailed in content. Realize that your plans will be interrupted and even disrupted. This is normal. However, as long as you keep working to stay on track, you will achieve your goals. Tenacity is the key to success.
Time Management

Author of several best-selling business development books, Steven Covey, makes a very distinct point about how important it is to spend more time on significant activities. These types of activities are what make us advance in our careers. Even though it’s often easier to spend our time on insignificant tasks (sometimes it makes us feel like we are accomplishing more), we must fight that urge. Using time wisely is a critical tool for your business success.

The following tips will help you to manage your time more effectively.

- **Consider a time management course.** Your broker may offer time management training in order to enhance productivity. If not, you may want to consider obtaining the training elsewhere such as a local college, REALTOR® association, or an online source. Franklin Covey courses are a great place to start. Visit www.franklincovey.com for more information.

- **Plan ahead.** Planning ahead for each week and each day will help to focus your efforts and control your business. Start by preparing a To-Do List the night before for the following day. Be sure to put the most urgent tasks first on the list and assign a time for completion. Any task that is not completed should be first on the To-Do List for the next day. There are numerous time management software programs available to assist you.

- **Control distractions.** You need to focus your efforts on the task at hand. It takes substantial discipline to keep the office, other associates, the phone, e-mails, or text messages from distracting you. In real estate, it’s inevitable that unexpected issues will arise. Try to prioritize and deal with them as quickly as possible. Learn to say, “No” when people make unwelcome or unnecessary demands on your time.

- **Multitask when possible.** Learning to utilize your time to the fullest can render huge results. Try checking your e-mail and taking appropriate action while you are waiting for a client or are on-hold on the phone. Return text messages or e-mails while waiting for lunch or dinner to be served or when riding as a passenger in a car.

- **Take a break.** Take a break when needed. Just a few minutes to stand, walk around, and stretch your legs can have a reenergizing effect on your mind and body. You will be more productive and better able to focus on the task at hand.

- **Schedule time off.** The real estate business can be extremely stressful and can take a toll on you and your business. Try to schedule time off for family, friends, personal interests, or just to relax around the house. You will be more productive and efficient in your efforts. Otherwise, you may find yourself burning out from the day-to-day stress a successful sales associate may encounter.

- **Monitor your time.** Purchase a day planner. Make a commitment that for a ten-day period, you will make a note of everything you do and how long you spent doing it. At the end of the ten days, total up how much time you actually spent doing the business of real estate - those things that actually generate money in your business. You may be surprised at how much time you are wasting. Armed with this information, you’ll be better able to take effective action with regard to time management.
Project Your Income and Expenses

When planning for your first year, you’ll need to consider the financial aspects of your business, which include the projected income and operating expenses, as well as what it will take to reach those financial goals.

Business Income

Most real estate professionals have some idea of how much income they need or want to make annually. It’s a good idea to put down those thoughts on paper and calculate what it would take to earn the desired amount.

On the pages that follow, we have provided you with a worksheet to use to do your calculations. A sample of a completed form follows the blank form to illustrate how to enter your personal business income goals and information.

BUSINESS PLAN WORKSHEET

<table>
<thead>
<tr>
<th>Desired Annual Income</th>
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<tbody>
<tr>
<td>Computing Monthly Income</td>
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<tr>
<td>1 Desired/Projected Annual Income</td>
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<tr>
<td>2 Monthly Income (Line 1 ÷ 12)</td>
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<table>
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<tr>
<th>Income from Listings</th>
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<tr>
<td>3 Estimated Percentage of Income from Listings</td>
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<tr>
<td>4 Annual Income from Listings (Line 1 x Line 3)</td>
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<tr>
<td>5 Monthly Income from Listings (Line 4 ÷ 12)</td>
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<td>6 Estimated Percentage of Income from Sales (100% - Line 3)</td>
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<td>7 Annual Income from Sales (Line 1 x Line 6)</td>
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<td>8 Monthly Income from Sales (Line 7 ÷ 12)</td>
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<th>Reaching Your Listing Income</th>
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<td>9 Average Commission in Your Area (Percentage)</td>
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<tr>
<td>10 Average Commission in Your Area (Dollar Amount)</td>
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<tr>
<td>11 Associate’s Average Listing Income (Less Broker’s Share)</td>
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<tr>
<td>12 Listings Sold to Reach Monthly Income (Line 5 ÷ Line 11)</td>
</tr>
<tr>
<td>13 Listings Needed Every Month (Assuming 80% of listings sell) (Line 12 ÷ 80%)</td>
</tr>
<tr>
<td>14 Presentations Needed to Get a Listing (Start with 3): Presentations Needed to Reach Monthly Required Listings (Line 13 x 3)</td>
</tr>
<tr>
<td>15 Contacts Needed per Listing Presentation (15): Contacts Required per Month to Reach Presentation Goal (Line 14 x 15)</td>
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<table>
<thead>
<tr>
<th>Reaching Your Sales Income</th>
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<tbody>
<tr>
<td>16 Average Sales Income in Your Area (Same as Line 11)</td>
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<tr>
<td>17 Sales Made to Reach Monthly Income (Line 8 ÷ Line 16)</td>
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<table>
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<th>Annual Listings and Sales Needed</th>
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<tr>
<td>Annual Listings (Line 13 x 12)</td>
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<tr>
<td>Annual Sales (Line 17 x 12)</td>
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<tr>
<td>Annual Presentations (Line 14 x 12)</td>
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<tr>
<td>Annual Contacts (Line 15 x 12)</td>
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<td>6 Estimated Percentage of Income from Sales (100% - Line 3)</td>
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<tr>
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</tr>
<tr>
<td>Annual Contacts (Line 15 x 12)</td>
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</tbody>
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According to the example shown above, the sales associate who wants to earn $75,000 per year would need to list 9-10 homes, sell 17-18 homes, give 28 presentations, and make 420 contacts during the year.

Taking the time to work through this worksheet for yourself will give you the information to set realistic weekly and monthly goals to help you reach those income projections. You can then check your progress each month and make whatever adjustments are needed to stay on target to reach your desired income.
Operating Expenses

The form below shows the potential operating expenses for the first year of your business. This number will vary on an individual basis but will give you a clear idea of the costs to consider.

<table>
<thead>
<tr>
<th>BUSINESS OPERATING EXPENSES WORKSHEET</th>
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<tbody>
<tr>
<td>Technology</td>
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<tr>
<td>Software</td>
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<td>Digital Camera</td>
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<tr>
<td><strong>Sub-Totals:</strong></td>
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Make Use of Marketing Resources

One thing is certain; you can’t survive in the world of professional real estate without good marketing. Getting your name out there and establishing yourself as a professional in your market area is necessary. When it comes to building your business, there is no substitute for a well-coordinated, professional marketing campaign. The goal is simple. When people think real estate, you want them to think of you. Start with the basics and build from there.

Personal Marketing Basics

- Know your market area and target market.
- Build your image.
- Be consistent in your message.
- Market across all types of media, including print and online.

Personal Marketing Resources

You have several vehicles available to you to help in your market efforts. Incorporate as many of these as you can into your personal marketing campaign. Be sure to measure your results. Anything worth doing is worth tracking. Keep a sharp eye on your costs, so you will know how to tweak your marketing efforts.

- Professional business photo. A current professional picture is necessary to get started. You will use this photo on almost every marketing piece, such as business cards, your website, blogs, property flyers, and direct mailings, just to name a few. What do you want the public to think about you? A picture speaks a thousand words. Build your image on all that you do.
• **Business cards.** The first and most basic marketing tool of all is the business card. Business cards are perhaps one of the most effective tools in building your brand. Your business card says a lot about you. Use it freely and on a daily basis. Get creative in different ways to use your card.

• **Professional logo.** Your company may have a logo but you should consider creating one of your own. A good professional logo makes a statement to the public about you and your image. Your logo shows the public what you want them to think about you. You should use your logo on all marketing material.

• **Personal brochure.** A personal brochure can go a long way in building your image and separating you from other real estate professionals. Brochures can be expensive if professionally produced, but they can have great impact. If this is something you can and want to do, you can find numerous companies online that produce professional brochures.

• **Professional website.** A website is necessary today. The public expects it. Professionally designed websites can be expensive, but the leads that a good website can produce may make it well worth your investment. If expense is an issue, as a REALTOR® you may have access to free websites that are available to customize. A website, if used properly, can go a long way in personal marketing. In fact, your website should be the central hub in your marketing efforts. Remember, your website must function as a lead generation tool, not just an online catalog or brochure.

• **Blog.** Think of your blog as your own personal online newspaper. This is an opportunity to get your personal message out, post articles, and link to informative sites. A blog can be a real image builder. You can build a professional blog for free by using Wordpress.com or Google’s Blogger.

  As a REALTOR®, you have access to hundreds of professionally written articles on all kinds of real estate topics. Go to Houselogic.com and log in by using your NAR ID number.

• **Social media.** This is a free and effective method of getting the word out. Your present and future customers are on social media sites; you need to be there, too. You should consider the following three social media sites:
  
  o Facebook
  o LinkedIn
  o Twitter

  Check your local resources for seminars, webinars, or other training on how to make the most of social media sites.
**PERSONAL MARKETING MISTAKES TO AVOID**

Marketing takes a lot of time and effort. To help keep you on task and moving forward, follow these tips.

- Don’t be a follower, be a leader. What’s right for someone else may not be right for you.

- Don’t overextend your financial resources. It’s a better approach to start small and grow as necessary.

- Don’t use jargon. Jargon is real estate industry terms that may not be familiar to the public.

- Don’t get in a rut. Try to refresh your plan and image as necessary; keep it fresh.

- Don’t be inconsistent. Be consistent in your message and marketing efforts through good times and bad.
CHAPTER 1 REVIEW QUESTIONS

1. Specializing in one type of property or on one particular neighborhood is a practice referred to as ________, which is considered one of the best ways to succeed in residential sales.

2. A residential transaction is defined as the sale of any improved residential property of _______ units or fewer, including (1) ________, (2) unimproved property intended for _______ units or fewer, (3) agricultural properties of _______ acres or less, (4) leases with options to purchase all or a portion of improved property of _______ or fewer residential units, and (5) dispositions of business interests for property of _______ or fewer residential units.

3. _______________ is a business specialization where licensees assist customers in locating and purchasing or leasing warehouse or manufacturing facilities.

4. _______________ is a business specialization option involving the listing and sale of businesses.

5. _______________ is a business specialization in which highly skilled real estate professionals answer questions and give expert advice to consumers.

6. The _______________ is a large national organization of real estate professionals, whose members are entitled to use the trademark of _______________.

7. The _______________ (doing business as _______________) is the largest trade organization of real estate professionals in the State of Florida.

8. Joining your local association of REALTORS® also gives you membership in _______ and _______ in addition to providing access to the _______.

9. The _______________ was established to promote higher standards of conduct in the real estate profession than the law provides.

10. The NAR Code of Ethics spells out the duties of REALTORS® to the _______ and _______, the _______, and _______.

11. Professional _______ and _______, obtained by completing education and training, will increase your credibility and distinguish you from the competition.

12. Real estate professionals are expected to have expert knowledge in the areas of _______, _______, and _______.

13. Real estate professionals must understand their market and have specific product knowledge including _______, _______, and _______.

14. The _______________ provides a detailed database of properties of all kinds which are available for sale or lease and is a critical resource for the success of your business.

15. When planning your first year of business, it is important to project your _______ and _______, as well as what it will take to reach those financial goals.
CHAPTER 1 PRACTICE EXAM

1. Greg grew up in and lives in a rural farming area. He’s very comfortable selling that type of property and knows he can work well with clients in that area. What property type will most likely be his specialty?
   a. Timeshare/Vacation
   b. Agricultural
   c. Commercial
   d. Industrial

2. Which of the following statements regarding property valuation is correct?
   a. A CMA is the same as an appraisal.
   b. Appraisals may only be performed by licensed appraisers.
   c. Appraisals must always be performed according to USPAP.
   d. Real estate licensees may perform appraisals for use in federally related transactions without a separate license.

3. Real estate licensees must know the procedures required for performing their duties when transacting real estate. Which of the following is NOT procedural knowledge that is required for a real estate licensee?
   a. Preparing a listing contract
   b. Providing an appraisal for use in a federally regulated transaction
   c. Preparing a purchase and sale contract
   d. Providing a comparative market analysis

4. The MLS system is one of the most important resources for success in the real estate business. Which of the following benefits is NOT provided by the MLS?
   a. Ability to market listings to a wide audience
   b. Access to a database of prospect names and contact information
   c. Access to a large database of properties for sale and lease
   d. Access to market data and statistics

5. Which of the following is NOT considered residential property according to the Florida Statutes?
   a. Two-acres of farmland
   b. A condominium unit
   c. A 50-unit motel
   d. A vacant lot zoned for a single family home

6. It is important to set definite and measurable goals when planning your business. Which one of these statements would NOT be considered a measurable goal?
   a. I will make two new contacts every day this week.
   b. I will practice my listing presentations twice a week with an experienced agent for the next two months.
   c. I will get three new listings this month.
   d. I will complete a property management seminar within the next year.

7. Jake has decided to specialize in working with clients who purchase and sell investment property such as malls and shopping centers. What property type will he be dealing with?
   a. Commercial
   b. Industrial
   c. Residential
   d. Agricultural

8. Alice is setting her goals. Which of the following would be considered an intermediate goal?
   a. I will complete the GRI certification in the next four years.
   b. I will practice listing presentations twice a week with an experienced agent for the next two months.
   c. I will open my own office within nine years.
   d. I will distribute 200 business cards every month for the next six months.

9. Which of the following is NOT a real estate trade organization?
   a. NAR
   b. FAR
   c. Florida REALTORS®
   d. DBPR
10. What area of real estate deals with absentee owners who buy income-producing property as an investment?
   a. Residential
   b. Agricultural
   c. Special use
   d. Property Management

11. Who may use the designation of REALTOR® when presenting themselves to the public?
    a. Anyone with a real estate license
    b. Any licensed real estate broker
    c. Only members of NAR
    d. Anyone performing real estate related services

12. Effective use of technology and online tools is key to your success in today’s Internet-based and technology-oriented society. Which of the following tools would NOT be considered a state-of-the-art practice?
    a. MLS
    b. E-mail
    c. Social media
    d. Paper forms

13. What term is used in timeshare ownership to refer to the right of the owner to use the property a specific period of time?
    a. Short-term lease
    b. Timesharing
    c. Interval ownership
    d. Shared-time ownership

14. Successful licensees are effective at time management. Which of the following would NOT be considered a good time management technique?
    a. Prepare a daily prioritized to-do list
    b. Control distractions
    c. Try not to take breaks
    d. Multitask when possible

15. Social media is a free and effective personal marketing tool for building your image and reaching new prospects. Which of the following would NOT be considered a social media tool?
    a. Facebook
    b. Magazine or newspaper
    c. LinkedIn
    d. Twitter
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REAL ESTATE LAWS AND RULES

CHAPTER 2

OVERVIEW

Holding a real estate license in the State of Florida is considered a privilege, not a right. This privilege was earned through hard work, dedication, and hours of studying. The license is key to earning a living in the real estate business. In your pre-license course, you may recall hearing that the purpose of the Florida Real Estate Commission (FREC) is to protect the public. Obviously, they protect the public by ensuring that those who enter the profession are honest, trustworthy, and have demonstrated minimal competency on an exam. Keep in mind that FREC’s job is also to protect the public from real estate licensees.

FREC protects the public through the rules, which it oversees, and the disciplinary process, which it administers. Attaining your real estate license was hard work. Don’t lose it due to negligence, poor service, or bad decision-making.

This chapter covers the highlights of the Florida Administrative Code Chapter 61J2 (F.A.C. 61J2) and Florida Statute 475 (F.S. 475). To read the complete rule (F.A.C. 61J2) or statute (F.S. 475), visit the Department of Business Professional and Regulation (DBPR) website at www.myfloridalicense.com/dbpr/re/statutes.html.

Please keep in mind that the rules and statutes will change from time-to-time. The rules and statutes referenced in this chapter were correct at the time of this publication. Always consult the website for the most current versions.

OBJECTIVES

After completing this chapter, you should be able to do all of the following:

- Know where to locate the key real estate license laws and rules
- Know the requirements for license renewal
- Understand the requirements for notifying the Department of changes
- Explain the rule for delivering a deposit to the broker
- Identify the duties associated with different brokerage relationships
- Understand the relationships between sales associate, broker, and principal
- Know the range of penalties for violations of real estate license laws

KNOWING THE REAL ESTATE LICENSE LAW

Real estate licensees are faced with many laws, rules, and ethical considerations while offering real estate services to the public. Upon receiving your initial sales associate license, you are immediately impacted by Chapters 455 and 475 of the Florida Statutes and FREC rules in 61J2 of the Florida Administrative Code. As you progress in your real estate career, these rules and the National Association of REALTORS® (NAR) Code of Ethics continue to govern all aspects of real estate practice for NAR members.
Chapter 455, under Title XXXII of the Florida Statutes, titled “Business and Professional Regulation: General Provisions,” is the law that regulates specific professions, including real estate. The intent of the legislature is “that persons desiring to engage in any lawful profession regulated by the department shall be entitled to do so as a matter of right if otherwise qualified.” These professions are regulated by the Florida Legislature “only for the preservation of the health, safety, and welfare of the public under the police powers of the state.” [F.S. 455.201]

One such example is F.S. 455.227(1)(t), which requires licensees to self-report a conviction, finding of guilt, plea of nolo contendere (no contest), or guilty regardless of adjudication, within 30 days.

Example:

At recent Commission meetings, a number of licensees were fined for not complying with this section. It is not an excuse to claim you did not know about the law. Fines are still levied for violations. In one case that was presented to FREC, a licensee pled guilty to health care fraud but, per advise from their attorney, did not report it to the DBPR until the conviction was handed down by the court. FREC assessed an administrative penalty to the licensee for not reporting within the 30-day requirement of the law after pleading guilty to the charges.

Real estate licensees are responsible and are held accountable for knowing and following the laws that apply to their profession in F.S. 455.

Chapter 475, under Title XXXII of the Florida Statutes, titled “Real Estate Brokers, Sales Associates, Schools, and Appraisers,” is the law that specifically regulates real estate licensees, schools, and appraisers. Real estate licensees are most familiar with this chapter of the statutes through their licensing courses.

Licensees should be especially familiar with the required brokerage relationship disclosures defined in F.S. 475.278, “Authorized brokerage relationships; presumption of transaction brokerage; required disclosures.”

Example:

Most disclosure laws came about from a class action lawsuit that took place from 1986 to 1992. A large real estate company in Minnesota failed to disclose to their customers (the sellers) that they were representing both buyers and sellers in the same transaction. The real estate company ended up paying $21,000,000 to settle the lawsuit; a very costly mistake.

After the lawsuit came to the attention of the real estate industry nationwide, states enacted laws that require real estate licensees to disclose how they represent the public in real estate transactions. Florida enacted its own law, which is enforced by auditors in the field when performing office inspections. All real estate licensees, whether brokers or sales associates, must be careful to ensure that these disclosures are properly made and the correct documentation is contained within their files.

All real estate licensees, whether broker or sales associate, are responsible and are held accountable for knowing and following the regulations in F.S. 475 that govern their daily activities of transacting real estate.
F.A.C. 61J2

The Florida Real Estate Commission (FREC or the Commission) was formed to enforce the Florida real estate license law in F.S. 475. In that effort, the Commission created rules in 61J2 of the Florida Administrative Code. These rules serve to address the many aspects of daily activities encountered by licensees. Many of these rules are discussed in this chapter.

Structure of the DBPR

Other Applicable Statutes

In addition to F.S. 455, F.S. 475, and F.A.C. 61J2 there are many of the laws that must be followed when engaged in real estate transactions. Examples of additional Florida statutes that affect the practice of real estate include the following:

- F.S. 404.056. Requires a radon gas disclosure to prospective buyers
- F.S. 689.261. Requires disclosure of property tax summary to prospective buyers
- F.S. 689.25. Relieves licensees from the responsibility of disclosing whether a property was the site of a homicide, suicide or death, or if an occupant is infected with AIDS or HIV
- F.S. 553.996. Provides a Florida Energy-Efficiency Rating Information brochure to all buyers
- F.S. 161.053. Concerns disclosures that pertain to Florida’s Coastal Construction Control Line (CCCL)
- F.S. 720.401. Requires disclosure of Homeowner’s Association to buyers
- F.S. 718.503. Requires that buyers of condominiums be provided with specific documents including a copy of the condominium governance
Federal Laws

Licensees, at times, may be responsible for the implementation of Federal laws. Examples of federal laws that affect the practice of real estate include the following.

- **Foreign Investment in Real Property Tax Act (FIRPTA).** FIRPTA is concerned with the sale of residential real property in excess of $300,000 when the property is owned by a foreign investor.

- **Federal Residential Lead-Based Paint Hazard Reduction Act of 1992.** This Act requires a pamphlet to be given to prospective buyers or tenants in addition to disclosure requirements. It also provides for a 10-day lead-based paint-testing period for sales transactions.

- **Federal environmental laws.** Federal environmental laws including the National Environmental Policy Act, the Clean Air Act, the Solid Waste Disposal Act, and the Federal Water Pollution Act.

Code of Ethics

As discussed in Chapter 1, members of NAR who use the designation of REALTOR® are held accountable to a strict code of ethics with respect to specific duties and actions when dealing with clients and customers, the public, and other real estate licensees. This code is enforced by local real estate boards.

The NAR Code of Ethics was created to give REALTORS® a higher standard of behavior than simply adhering to the minimum requirements of law. These ethical standards are of great importance to any licensee who seeks a successful and rewarding career in real estate, where trust, honesty, reputation, and ongoing relationships are key to obtaining customers and growing their business.

DISCIPLINE

Disciplinary Authority of the Commission

The Commission may deny an application for licensure or may discipline licensees for violation of F.S. 475 or any rule enacted under its authority. A licensee who is found to be guilty of a violation may receive one of the following disciplinary actions: issued a reprimand or an administrative fine up to $5,000 per offense, placed on probation, or have their license suspended for up to ten years or permanently revoked. [F.S. 475.25(1)]

F.S. 455 titled “The Regulation of Professions and Occupations Act” provides the legal authority under which investigations and hearings are conducted. Hearing procedures are established by F.S. 120, the Administrative Procedures Act. The Commission can consider either mitigating or aggravating circumstances.

**Mitigating circumstances** are considered to be extenuating, and reduce the degree of culpability. **Aggravating circumstances** add to the injury caused by the act. Violations that involve mitigating circumstances will generally carry a lesser penalty than those that involve aggravating circumstances. If the charge against a licensee includes multiple counts or a combination of violations, the Commission can impose a higher penalty. [F.S. 455.2273]

F.S. 455.2273 requires licensing agencies to adopt guidelines under which disciplinary actions may be imposed on those persons and entities under their jurisdiction. The Commission has adopted such guidelines, which are incorporated into F.A.C. 61J2-24.001(3).
Administrative complaints must be filed within five years of the time of the act which
gives rise to the complaint, or within five years from discovery of the act with due
diligence.

The Commission must inform the Division of Florida Condominiums, Timeshares,
and Mobile Homes when any disciplinary action is taken against any of its licensees.
[F.S. 475.455]

The Commission is also required to report any violation of law to the proper
prosecuting authority for possible criminal prosecution. [F.S. 475.25(7)]


The purpose of the disciplinary guidelines is to give notice to licensees of the range
of penalties that normally would be imposed for each count during a formal or informal
hearing. For purposes of this rule, the order of penalties, ranging from lowest to highest,
is *reprimand, fine, probation, suspension, and revocation or denial*.

Disciplinary guidelines are based on a single violation. The disciplinary guidelines do
not preclude discipline pursuant to a stipulation, settlement agreement, or a letter of
guidance. The maximum penalties are revocation or denial of license. The Commission
cannot deny payment of a commission to a licensee.

Minor violations may be dealt with by issuing a citation or a notice of noncompliance.
Investigators for the Department are authorized to issue citations and notices of
noncompliance only for minor offenses specified by the Commission.

Most violations are identified with specific procedural actions in F.A.C. 61J2-24.
However, licensees are also held accountable for rules in general, and for acting
ethically and responsibly as illustrated by the following violations that could require a full
disciplinary hearing.

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<th>Rule or Statute</th>
<th>Violation</th>
<th>First Violation</th>
<th>Second Violation</th>
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<tr>
<td>F.A.C 61J2-24.001(3)(f)</td>
<td>Violation of any rule or order or provision under F.S. 475 and F.S. 455</td>
<td>A fine ranging from $250 to $1,500 and license suspension to revocation</td>
<td>A fine ranging from $1,000 to $5,000 and license suspension to revocation</td>
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<tr>
<td>F.A.C. 61J2-24.001(3)(n)</td>
<td>Obtained a license by fraud, misrepresentation of concealment</td>
<td>A fine ranging from $250 to $1,500 and 30-day license suspension to revocation</td>
<td>A fine ranging from $1,000 to $5,000 and license suspension to revocation</td>
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<tr>
<td>61J2-24.001(3)(f)</td>
<td>Convicted or found guilty of a crime related to real estate or involving moral turpitude or fraudulent or dishonest dealing</td>
<td>A fine ranging from $250 to $1,500 and a 30-day license suspension to revocation</td>
<td>A fine ranging from $1,000 to $5,000 and license suspension to revocation</td>
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<td>F.A.C. 61J2-24.001(3)(j) F.S. 475.25(1)(i)</td>
<td>Becoming temporarily incapacitated from acting as a sales associate with safety to investors or those in a fiduciary relationship with him or her because of impairment by drunkenness, or use of drugs or temporary mental derangement</td>
<td>A fine ranging from $250 to $1,500 and a 30-day license suspension to revocation</td>
<td>A fine ranging from $1,000 to $5,000 and license suspension to revocation</td>
</tr>
<tr>
<td>F.A.C. 61J2-24.001(3)(o) F.S. 475.25(1)(n)</td>
<td>Confinement in jail, prison, or mental institution, or through mental disease can no longer safely be entrusted to competently deal with the public.</td>
<td>A fine ranging from $250 to $1,000 and license suspension to revocation</td>
<td>A fine ranging from $1,000 to $5,000 and license suspension to revocation</td>
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LICENSE RENEWAL

This section summarizes a few of the key laws and rules related to license renewal and exemptions from renewal requirements.


F.A.C. Rule 61J2-3.020 and F.S. 475.17(3) deal with the topic of completing the post-license (first renewal) requirements. All licensees, whether active or inactive, must satisfactorily complete a FREC-approved post-licensing course prior to their license expiration date on their initial license. Any sales associate who does not successfully complete the post-licensing requirements prior to their license expiry date may no longer practice real estate; their initial license becomes null and void. It is very important for licensees to pay attention to the first renewal requirements and deadlines to avoid losing their license and employment.

- Post-license education. The post-license education may be completed by classroom or distance learning. When completed by classroom, attendance is mandatory. A classroom student who misses more than 10% of the instruction may not take the end-of-course final examination. A student who makes up missed hours must do so and take the missed final examination within 30 days of the original examination. Make-up hours must consist of the original course materials that were missed. [F.A.C. 61J2-3.020(8)]

  - Sales associate first renewal. A sales associate must complete a 45-hour post-license course prior to the expiration date of his or her initial license period. The license of a sales associate who fails to complete this requirement will become void and the licensee will be out of business. If the licensee wishes to continue in the real estate profession, he or she is required to take the 63-hour pre-license course over again and pass another state examination.

  - Broker first renewal. A broker must complete one or more courses, which total 60 hours of post-license education prior to the expiration date of his or her initial license period. The license of a broker who fails to complete this requirement will become void and the licensee will be out of business. The licensee may revert to an active sales associate by taking a 14-hour CE course during the six months immediately following expiration of the broker’s license, submit proof of completion, and request an active sales associate’s license. To be licensed again as a broker, the licensee would be required to complete the 72-hour broker pre-license educational course and pass another state examination.

- End-of-course exam. Licensees must successfully pass the post-license end-of-course exam with a score of 75% or higher to receive credit for the course. Upon passing the exam, licensees will receive a course completion certificate. Upon successful course completion, the course provider will electronically submit the continuing education results for the licensee.

  Anyone who fails an end-of-course final exam may take an alternate final exam after waiting a minimum of 30 days, without taking the entire course again. A licensee may bypass the 30-day wait period by retaking the entire course from the beginning. The retest must be completed within one year of the original exam. If the licensee fails the alternate exam, they must repeat the entire course.
Continuing Education Requirements [F.S. 475.182, F.A.C. 61J2-3.009]

F.A.C. Rule 61J2-3.009 and F.S. 475.182 deal with the topic of successfully completing continuing education (CE) courses to fulfill requirements for license renewal. This applies to active and inactive brokers and sales associates. Any license that is not renewed at the end of the license period will automatically revert to involuntarily inactive status. Careful attention to the terms and details in this section will ensure that you maintain your license status without unnecessary interruption.

Key information from the laws and rules includes:

- **License renewal.** Following the post-license (first renewal) period, active and inactive brokers and sales associates must apply for renewal, pay a renewal fee, and provide proof of satisfactory completion of an approved CE course during each biennium of a license period.

- **CE hours.** A minimum of 14 hours of CE must be completed during each license renewal period, following the first renewal period. F.A.C. 61J2-3.009 requires the 14 hours to include three hours of real estate core law, three hours of business ethics, and 8 hours of specialty courses approved by the FREC. Three hours may be obtained by attending one legal agenda session of the FREC.

- **Completion requirements.** CE courses may be completed by classroom instruction or distance learning (online).
  
  - **Classroom requirements.** To complete the CE classroom course requirements, licensees must attend a minimum of 90% of each of the required 14 hours. No end-of-course exam is required for classroom completion.

  - **Distance education requirements.** For distance or online versions of the 14-hour CE course, licensees must achieve a score of 80% or higher on a 30-question, multiple-choice, end-of-course exam. Licensees who fail the course exam must take a different, alternate exam. Distance and online licensees will have phone access to an instructor for inquiries related to the course or exam contents.
• Exemptions.
  
  ○ Actively licensed Florida attorneys in good standing with the Florida Bar who are otherwise qualified under the real estate license law are exempt from the CE requirements.

  ○ An instructor who teaches an approved CE course may use the course towards the CE requirement on a classroom hour-for-hour basis.

  Continuing Education (CE) Requirements

  Sales Associate or Broker
  14-Hour Course
  Classroom: No Course Exam
  Distance (Online): Pass 80% or Higher

  Course Completion Certificate
  State Renewal Fee
  No State Exam
  Course Provider Reports Completion to DBPR

Inactive Renewals [F.A.C. 61J2-1.014]

For renewal purposes, no distinction is made between an active and a voluntary inactive license. All licensees are required to renew their license every two years.

License Reactivation [F.S. 475.183(2), F.A.C. 61J2-3.010]

A licensee who does not request renewal of their license, pay the required fees, or maintain their CE requirements will have their license automatically placed in an involuntary inactive status. A license may remain in an involuntary inactive status for no more than two years.

A licensee may change the involuntary inactive status of their license to voluntary inactive or active at any time during the first 12 months. To change the status, the licensee must complete the required 14-hour CE course and pay an additional fee.

If a licensee does not change the involuntary inactive status of their license within the first year, the licensee must complete a 28-hour reactivation course and pay an additional fee within months 13 through 24. If the license is not brought current within two years, the license automatically expires.

A licensee who practices real estate without a valid or current license is subject to a full disciplinary hearing and one of the following range of penalties. [F.A.C. 61J2-24.001(w) Disciplinary Guidelines]

  • First violation. A fine ranging from $250 to $2,500 and license suspension to revocation

  • Second violation. A fine ranging from $1,000 to $5,000 and license suspension to revocation
Members of the Armed Forces and Spouses

Exemption from Licensure Renewal Provisions

A licensee who is the spouse of a member of the Armed Forces of the United States shall be exempt from all licensure renewal provisions under the Rules of the Commission as long as the member of the Armed Forces of the United States is on active duty and for a period of two years after the member’s discharge from active duty with the Armed Forces, if said licensee is not engaged in the practice of real estate brokerage activity in the private sector for profit. This exemption shall only apply in cases of the licensee’s absence from the state because of the member’s duties with the Armed Forces. [F.A.C. 61J2-1.015]

Professional Licenses

The Department will issue a professional license to applicants who are or were active duty members of the armed forces of the U.S. Former military members must have received an honorable discharge. A professional license will also be issued to a spouse or to one who was married at any time to the member during any period of active duty, or to a surviving spouse who was married to the active duty member at the time of their death. The applicant must hold a valid professional license issued by another state, the District of Columbia, any possession or territory of the U.S., or any foreign jurisdiction. The initial application fee will be waived. [F.S.455.02(3)(a)]
NOTIFICATION OF CHANGES

This section summarizes a few of the key laws and rules for required reporting of changes to the Department.

Change of Name [F.A.C. 61J2-9.007]

If a name or trade name is lawfully changed, a request for the reissuance of the license or registration must be filed, and the license or registration must be reissued.

Change of Employer [F.S. 475.23]

When a sales associate changes employers, they must notify the Commission of the change no later than ten days after the change by using the form provided by the Commission. Sales associates must be employed by a broker or owner-developer to maintain an active license and practice real estate. When a sales associate changes employers, they retain their active license status but could be fined if they do not notify the Commission within ten days.

A sales associate who operates without a registered employer due to failure to renew or properly register could be issued a citation and fined $500. [F.A.C. 61J2-24.002(k) Citation Authority]

Change of Mailing Address [F.A.C. 61J2-10.038]

F.S. 455.275(1) defines current mailing address as the current residential address, which is used by a licensee to receive mail through the United States Postal Service. A licensee is required to notify the Department in writing of their current mailing address and any change in the current mailing address within ten days after the change. Failure to notify the Department could result in the issuance of a citation and a fine of $500. [F.A.C. 61J2-24.002(z) Citation Authority]

Change in Residency [F.S. 475.180(2)(a), F.A.C. 61J2-26]

Any resident licensee who becomes a nonresident must notify the Commission within 60 days of the change in residency and comply with nonresident requirements. Failure to notify and comply is a violation of the license law, subject to penalties.

Reporting Criminal Convictions [F.S. 455.227(1)(t)]

As discussed earlier in this chapter, Florida statutes require that a licensee report to the Commission within 30 days after being convicted, found guilty, or entered a plea of nolo contendere (no contest) or guilty to a crime in any jurisdiction regardless of adjudication.

Failure to do so could result in a full disciplinary hearing and one of the following range of penalties. [F.A.C. 61J2-24.001(nn) Disciplinary Guidelines]

- First violation. A fine ranging from $250 to $1,000 and license suspension to revocation
- Second violation. A fine ranging from $1,000 to $5,000 and license suspension to revocation
BUSINESS OPERATIONS

This section summarizes a few of the key laws and rules related to the day-to-day business operations performed by sales associates.

Advertising [F.A.C. 61J2-10.025]

All advertising must be in a manner in which reasonable persons would know they are dealing with a real estate licensee. Advertisements placed by sales associates must include the licensed name of the brokerage firm under which the sales associate is employed. When the licensee’s personal name appears in the advertisement, at the very least the licensee’s last name must be used in the manner in which it is registered with the Commission.

When advertising on a website, the brokerage firm name must be placed adjacent to, immediately above, or below the point of contact information. Point of contact information refers to such information as mailing address, physical street address, e-mail address, telephone number, or fax number.

Advertisements may not be fraudulent, false, deceptive, or misleading. Placing such an ad could result in a full disciplinary hearing and one of the following range of penalties. [F.A.C. 61J2-24.001(d) Disciplinary Guidelines]

- **First violation.** A fine ranging from $250 to $1,000 and 30 to 90 day license suspension
- **Second violation.** A fine ranging from $1,000 to $5,000 and 90 day license suspension to revocation

Possible lesser penalties include:

- Advertising false, inaccurate, misleading, or exaggerated information could result in the issuance of a citation and a fine of $500. [F.A.C. 61J2-24.002(o)]
- Advertising in a manner in which a reasonable person would not know one is dealing with a real estate licensee or brokerage, failing to include the registered name of the brokerage firm in the advertisement, or failure to use the licensee’s last name, as registered with the Commission in an advertisement could also result in the issuance of a citation and a fine of $500. [F.A.C. 61J2-24.002(u)]

Use of Association Names [F.A.C. 61J2-10.027]

A licensee may not use an identification or designation of any association or organization having to do with real estate unless they are entitled to do so. Using the name or identification of an association or organization when the licensee is not in good standing or otherwise not entitled could result in the issuance of a citation and a fine of $300. [F.A.C. 61J2-24.002(v)]

Kickbacks or Rebates [F.A.C. 61J2-10.028]

A real estate licensee may not receive, or agree to receive, directly or indirectly, anything of value in exchange for the placement of, or favor in, any business transaction in connection with a real estate transaction.
Exceptions

The exception is when a licensee performs a service that entitles them to any such fee, has the appropriate license to perform the service (if one is required), and discloses and receives consent from all interested parties regarding the fee payment. A licensee could also accept a legal kickback fee not involving a service of the settlement if the kickback is disclosed to all interested parties. It is not considered a violation of F.S. 475 if a licensee shares brokerage compensation with a party to the real estate transaction with full disclosure to all interested parties.

Handling Deposits [F.A.C. 61J2-14.009]

A deposit may be in the form of money, personal property, real property, or anything of value that can be converted to cash. Typically, the deposit is intended to become a partial payment of the purchase price at closing.

Postdated checks are considered promissory notes and can be accepted as earnest money with the seller's approval. [F.A.C. 61J2-14.008(1)(a)]

A sales associate who receives a deposit must deliver it to the broker or employer no later than the end of the business day following receipt of the item to be deposited. Saturday, Sundays, and legal holidays are not considered business days.

Receipt by a sales associate constitutes receipt by the broker. Failure of a sales associate to place money to be escrowed with their employer could result in a full disciplinary hearing and one of the following range of penalties. [F.A.C. 61J2-24.001(1) Disciplinary Guidelines]

- **First violation.** A fine ranging from $250 to $1,000 and 30 day license suspension to revocation
- **Second violation.** A fine ranging from $1,000 to $5,000 and license suspension to revocation

Rental Information [F.A.C. 61J2-10.030]

If a broker or sales associate attempts to negotiate a rental, or furnishes rental information to a prospective tenant for a fee paid by the tenant, the licensee must provide the prospective tenant with a written contract that reads as follows:

If the rental information provided under this contract is not current or accurate in any material aspect, you may demand within 30 days of this contract date a return of your full fee paid. If you do not obtain a rental, you are entitled to receive a return of 75% of the fee paid, if you make such demand within 30 days of this contract date.

Two different situations might arise:

1. The tenant applicant does not like any of the rental properties available. In this case, they may request a refund of 75% of any fee paid.

2. The tenant applicant was misled or deceived concerning the terms or availability of the property offered. If the broker materially misrepresented what was offered, the tenant applicant can request a 100% refund of any fee paid.

In either case, the request must be made within 30 days of the contract date.
The form of the contract or receipt agreement must be as prescribed by the Commission as shown above. Each rental data company must furnish the Department with a copy of its current contract or receipt agreement within 30 days prior to use.

Rental information violations are considered a misdemeanor of the first degree. In addition, the license of a broker or sales associate who is found guilty of a rental information violation is subject to disciplinary action by the Commission. [F.S. 475.453] [F.A.C. 61J2-10.030]

**Timeshare Listing Agreements [F.A.C. 61J2-23.001(1)(a)]**

Whenever a licensee lists a timeshare resale unit, the contract must contain specific language related to common area expenses, ad valorem taxes, and other ownership charges. The disclosure that follows must appear just above the space reserved for the signature(s) of the buyer in conspicuous type as shown below.

**Timeshare Purchase and Sale Agreements [F.A.C. 61J2-23.002(1)]**

Whenever a licensee negotiates a contract for the resale of a timeshare resale unit, the contract must contain specific language related to common area expenses, ad valorem taxes, and other ownership charges. The disclosure that follows must appear just above the space reserved for the signature(s) of the purchaser in capitalized ten-point, bold type or larger.

---

**THE CURRENT YEAR’S ASSESSMENT FOR COMMON EXPENSES ALLOCABLE TO THE TIMESHARE PERIOD YOU ARE PURCHASING IS $__________. THIS ASSESSMENT, WHICH MAY BE INCREASED FROM TIME-TO-TIME BY THE MANAGING ENTITY OF THE TIMESHARE PLAN, IS PAYABLE IN FULL EACH YEAR ON OR BEFORE ________. THIS ASSESSMENT (INCLUDES) (DOES NOT INCLUDE) YEARLY AD VALOREM REAL ESTATE TAXES, WHICH (ARE) (ARE NOT) BILLED AND COLLECTED SEPARATELY.**

If ad valorem real property taxes are not included in the current year’s assessment for common expenses, the following statement must be included:

**THE MOST RECENT ANNUAL ASSESSMENT FOR AD VALOREM REAL ESTATE TAXES FOR THE TIMESHARE PERIOD YOU ARE PURCHASING IS $__________. EACH OWNER IS PERSONALLY LIABLE FOR THE PAYMENT OF HIS ASSESSMENT FOR COMMON EXPENSES, AND FAILURE TO TIMELY PAY THESE ASSESSMENTS MAY RESULT IN RESTRICTION OR LOSS OF YOUR USE AND/OR OWNERSHIP RIGHTS.**
A licensee who fails to disclose all material aspects of the resale of timeshare period(s) or timeshare plans and the rights and obligations of both buyer and seller could be subject to a full disciplinary hearing and one of the following range of penalties.

[F.A.C. 61J2-24.001(hh) Disciplinary Guidelines]

- **First violation.** A fine ranging from $250 to $1,000 and license suspension
- **Second violation.** A fine ranging from $1,000 to $5,000 and license suspension to revocation

**EMPLOYMENT AND BROKERAGE RELATIONSHIPS**

**Employment by More than One Entity [F.S. 475.215(2), F.A.C. 61J2-6.006]**

A sales associate may only be employed by one registered employer at any one time.

**Collect Money Only from Employer**

A sales associate may not collect money in connection with a real estate transaction except in the name of the employer.

- A sales associate is employed under a broker or an owner-developer, not by the principal (or customer). The broker is employed by and represents the principal, and has a fiduciary relationship with them. Money received as compensation for real estate transactions are paid to the broker, not the sales associate.
- A sales associate is an agent of the employing broker and acts on behalf of the broker. A sales associate receives compensation only from his or her employing broker.
- A sales associate can, however, be paid a portion of a commission by a closing agent if such instructions have been provided in writing by the broker.

**Single Agency Relationship**

**License Status of Officers and Directors [F.A.C. 61J2-5.016]**

A sales associate may not be registered as an officer or director of a brokerage corporation, or general partner of a brokerage partnership. A sales associate who serves as an officer or director of a registered brokerage corporation could be issued a citation and receive a fine of $200. [F.A.C. 61J2-24.002(s)]
Brokerage Relationship Duties [F.S. 475.278]

A potential customer can choose representation and establish an authorized brokerage relationship by electing to be represented as a transaction broker, single agent, or a no brokerage relationship. Licensees are held accountable for performing specific duties according to the type of relationship, as summarized in the table below.

<table>
<thead>
<tr>
<th>Duty</th>
<th>No Brokerage</th>
<th>Transaction Broker</th>
<th>Single Agent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deal honestly and fairly</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Account for all funds</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Disclose all known facts that affect the value of residential property</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Skill, care, and diligence</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Present all offers and counteroffers</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Limited confidentiality</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Additional agreed duties</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Confidentiality</td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Obedience</td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Loyalty</td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Full disclosure</td>
<td></td>
<td></td>
<td>✓</td>
</tr>
</tbody>
</table>

Brokerage Relationship Disclosures [F.S. 475.278]

A broker may be employed by a member of the public in one of the following three different relationships:

- Transaction broker
- Single agent
- No brokerage relationship

Written disclosure, which specifies the nature of the relationship a broker has with a member of the public and the duties inherent in the relationship, is required in single agency and no brokerage relationships. (See the end of the chapter for sample disclosures.) Written disclosures are not required when acting in the capacity of a transaction broker or in nonresidential real estate transactions. Licensees are not required to disclose the duties associated with transaction brokerage.

For first time violations only, failure to give the appropriate disclosure or notice at the appropriate time could result in the issuance of a citation and a fine of $300. [F.A.C. 61J2-24.002(i)]

Regardless of the relationship that is established, sellers of residential property, along with licensees, must disclose all known facts that materially affect the value of residential real property and are not readily observable to the buyer.

Disclosure Exemptions [F.S. 475.278(5)(b)]

Disclosure requirements do not apply when a licensee knows that a transaction broker or a single agent is representing a potential seller or buyer. Disclosure is not required when an owner is selling new residential construction units built by the developer in which the circumstances or settings should reasonably inform the potential buyer that the licensee is acting on behalf of the owner. This may occur when the office
location, signage, placards, or a name badge would indicate the licensee is acting in such a capacity.

The following situations are exempt from the disclosure requirements.

- Nonresidential transactions
- The rental or lease of real property, unless an option to purchase all or a portion of the property improved with four or fewer units is given
- A bona fide open house or model home showing that does not involve eliciting confidential information, the execution of a contractual offer or an agreement for representation, or negotiations concerning price terms, or conditions of a potential sale
- Unanticipated casual conversations between a licensee and a seller or buyer which do not involve eliciting confidential information, the execution of a contractual offer or agreement for representation, or negotiations concerning price, terms, or conditions of a potential sale
- Responding to general factual questions from a potential buyer or seller concerning properties that have been advertised for sale
- 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

Illegal Dual Agency [F.S. 475.01(k)]

An agency relationship is created when a broker accepts employment under a single agency agreement. A broker may represent a seller, buyer, property owner, or tenant. Any attempt to represent both parties in a transaction would create an illegal dual agency.

Consent to Transition to Transaction Broker [F.S. 475.278(2)(b)(2)]

Transition from one role to another may become necessary when a broker has been employed as a single agent by a seller and is subsequently employed by the buyer as a single agent. If the buyer becomes interested in the seller’s property, the broker would have two principals, which would be an illegal dual agency. A broker can both list and sell a property in what is called an in-house transaction. The broker, however, cannot be an agent for both parties. Transition from single agent to transaction broker resolves this conflict.

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 written disclosure required and the principal gives their written consent before a change in the relationship occurs. This transition disclosure must be in writing and submitted to the principal as a separate and distinct document or included as part of other documents such as a listing agreement or other agreement for representation. If the principal does not initial or sign the form, thereby refusing to give their consent to the broker’s transition, the broker must continue to act as a single agent. (See the end of this chapter for a sample disclosure.)
Each party must understand the role of the broker. A party is entitled to a different level of representation when the broker is a single agent than when the broker is a transaction broker. When in a transaction broker relationship, the principal agrees to become a customer rather than a principal. It is not necessary for a licensee to remind the parties at the time of the transition from a single agent relationship to a transaction broker relationship. However, a verbal disclosure at the point of the transition is recommended to avoid possible problems later.

Caution, again, is necessary when making the transition from single agent to transaction broker. A single agent who has come into possession of confidential information may not use or disclose this information to anyone for the rest of their life. Transition from one role to another does not remove the confidentiality created under the fiduciary relationship that was established in the original single agency relationship.

**PROPERTY MANAGEMENT VIOLATIONS**

The Commission deals with an increasing number of cases related to property management violations. With respect to sales associates, these cases typically involve licensees who act as investors or beyond the scope of a sales associate.

- **Licensee acting in the capacity of an investor.** If a licensee acts as an investor, the licensee must ensure that all parties are aware that the licensee is not acting as a real estate licensee.

  **Example:** The Commission has heard cases where an individual who was acting as an investor gave out business cards and used stationary indicating that they were a licensee. The Commission ruled in these cases that the individual was in fact acting as a licensee, not an investor.

  A licensee can act as a private investor. However, if the licensee leads the public to believe that they are dealing in a real estate brokerage transaction, and the other party is damaged or harmed, the other party may be entitled to collect from the Real Estate Recovery Fund, resulting an automatic suspension to the licensee.

- **Licensee acting beyond the scope of a sales associate.** A sales associate may only receive compensation from their employing broker, and not from any other source in regards to the transaction of real estate.

  **Example:** The Commission has heard cases where the sales associate’s employing broker does not handle property management, so the sales associate set up their own company to handle property management. In these cases, the sales associate was found guilty of operating as a broker while licensed as a sales associate.

  A licensee who practices beyond their scope as a sales associate could be subject to a full disciplinary hearing and one of the following range of penalties. [F.A.C. 61J2-24.001(x)]

  - **First violation.** A fine ranging from $250 to $1,000 and license suspension to revocation
  - **Second violation.** A fine ranging from $1,000 to $5,000 and license suspension to revocation
REQUIRED DISCLOSURE FORMS

The examples of the required disclosure forms used in order to comply with the Brokerage Relationship Disclosure Act are shown below.

SINGLE AGENT NOTICE

FLORIDA LAW REQUIRES THAT REAL ESTATE LICENSEES OPERATING AS SINGLE AGENTS DISCLOSE TO BUYERS AND SELLERS THEIR DUTIES.

As a single agent, (Insert the name of the Real Estate Entity) and its Associates owe to you the following duties:

1. Dealing honestly and fairly;
2. Loyalty;
3. Confidentiality;
4. Obedience;
5. Full disclosure;
6. Accounting for all funds;
7. Skill, care, and diligence in the transaction;
8. Presenting all offers and counteroffers in a timely manner, unless a party has previously directed the licensee otherwise in writing; and
9. Disclosing all known facts that materially affect the value of residential real property and are not readily observable.

__________________________________________  ____________________________
Date                                              Signature

NO BROKERAGE RELATIONSHIP NOTICE

FLORIDA LAW REQUIRES THAT REAL ESTATE LICENSEES WHO HAVE NO BROKERAGE RELATIONSHIP WITH A POTENTIAL SELLER OR BUYER DISCLOSE THEIR DUTIES TO SELLERS AND BUYERS.

As a real estate licensee who has no brokerage relationship with you, (Insert the name of the Real Estate Entity) and its Associates owe to you the following duties:

1. Dealing honestly and fairly;
2. Disclosing all known facts that materially affect the value of residential real property which are not readily observable to the buyer; and
3. Accounting for all funds entrusted to the licensee.

__________________________________________  ____________________________
Date                                              Signature
CONSENT TO TRANSITION TO TRANSACTION BROKER

FLORIDA LAW ALLOWS REAL ESTATE LICENSEES WHO REPRESENT A BUYER OR SELLER AS A SINGLE AGENT TO CHANGE FROM A SINGLE AGENT RELATIONSHIP TO A TRANSACTION BROKERAGE RELATIONSHIP IN ORDER FOR THE LICENSEE TO ASSIST BOTH PARTIES IN A REAL ESTATE TRANSACTION BY PROVIDING A LIMITED FORM OF REPRESENTATION TO BOTH THE BUYER AND THE SELLER. THIS CHANGE IN RELATIONSHIP CANNOT OCCUR WITHOUT YOUR PRIOR WRITTEN CONSENT.

As a transaction broker, (Insert the name of the Real Estate Firm) and its Associates provide to you a limited form of representation that includes the following duties:

1. Dealing honestly and fairly;
2. Accounting for all funds;
3. Using skill, care, and diligence in the transaction;
4. Disclosing all known facts that materially affect the value of residential real property and are not readily observable to the buyer;
5. Presenting all offers and counteroffers in a timely manner, unless a party has previously directed the licensee otherwise in writing;
6. 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 of any other information requested by a party to remain confidential; and
7. Any additional duties that are entered into by this or by separate written agreement.

Limited representation means that a buyer or seller is not responsible for the acts of the licensee. Additionally, parties are giving up their rights 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.

________________________________ I agree that my agent may assume the role and duties of a transaction broker. (Must be initialed or signed.)
CHAPTER 2 REVIEW QUESTIONS

1. Chapter ________ of the Florida Statutes is the law that regulates specific professions, including real estate.

2. Chapter ________ of the Florida Statutes is the law that specifically regulates real estate licensees, schools, and appraisers.

3. The Florida Real Estate Commission (FREC) created rules in _____________ of the Florida Administrative Code in order to enforce the Florida real estate license law.

4. ____________ is a Federal law that is concerned with the sale of residential real property in excess of $300,000 when the property is owned by a _____________________.

5. The ____________________ was created to give REALTORS® a higher standard of behavior.

6. The Commission may deny an application for licensure or may discipline licensees for violation of F.S. ___________ or any rule enacted under its authority.

7. For purposes of F.A.C. 61J2, the order of penalties, ranging from lowest to highest, is ____________, ____________, ____________, ____________, and ____________.

8. All sales associates, whether active or inactive, must satisfactorily complete a FREC-approved, ____________ course containing _____ hours of education prior to their license expiration date on their initial license.

9. A minimum of ________ hours of CE must be completed during each license renewal period, following the first renewal period.

10. When a sales associate changes employers, they must notify the Commission of the change no later than ____________ after the change.

11. Florida statutes require that a licensee report to the Commission within 30 days after a licensee is ____________________, ____________, or ____________________________ or _________ to a crime in any jurisdiction regardless of adjudication.

12. Advertisements may not be ____________, ____________, ____________, or ____________.

13. A sales associate who receives a deposit must deliver it to the broker or employer no later than the ____________________________ following receipt of the item to be deposited.

14. A sales associate may only be employed by ________________ at any one time.

15. Written disclosure, which specifies the nature of the relationship a broker has with a member of the public and the duties inherent in the relationship, is required in ________________ and ________________ relationships.
CHAPTER 2 PRACTICE EXAM

1. Which entity is NOT regulated by F.S. 475?
   a. Building codes
   b. Real estate licensees
   c. Real estate schools
   d. Appraisers

2. Upon failing to complete the 14-hour renewal requirements prior to license expiry, a licensee may change the involuntary inactive status of their license to voluntary inactive or active during the first 12 months. What must a licensee do to accomplish this?
   a. Complete a 28-hour reactivation course
   b. Complete a 63-hour post-license course
   c. Submit a new application to the DBPR
   d. Complete a 14-hour CE course and pay a fee

3. Which statement correctly describes the role of the sales associates?
   a. A sales associate represents the principal in a real estate transaction.
   b. A sales associate is an agent of and acts on behalf of their employing broker.
   c. A sales associate is employed by multiple brokers to transact real estate.
   d. A sales associate receives compensation directly from the customer in a real estate transaction.

4. All real estate licensees, whether in a no brokerage, transaction broker, or single agent relationship, are accountable for performing which duties?
   a. Dealing honestly and fairly, limited confidentiality, and full disclosure
   b. Presenting all offers and counteroffers, obedience, and limited confidentiality
   c. Dealing honestly and fairly, accounting for all funds, and disclosing all known material facts
   d. Obedience, loyalty, and full disclosure

5. Minor violations of F.S. 475 or F.A.C. 61J2 would typically result in which disciplinary action?
   a. A citation or notice of noncompliance
   b. Probation
   c. License suspension
   d. License revocation

6. A sales associate who fails to complete the post-license requirements by the renewal deadline may no longer practice real estate. What action must be taken to regain their license?
   a. Complete the 28-hour reactivation education within 12 months and pay a fee
   b. Complete the 28-hour reactivation education within 24 months and pay a fee
   c. Repeat the 63-hour pre-license education and submit a new license application package
   d. Repeat the 45-hour post-license education

7. When a licensee changes their employer they must notify the DBPR within how many days?
   a. 7
   b. 10
   c. 30
   d. 60

8. A licensee is representing both the buyer and the seller in the same transaction. What is this called?
   a. Good business
   b. Profitable transaction
   c. Illegal dual agency
   d. Multiple customer transaction

9. If a licensee advertises false, inaccurate, misleading, or exaggerated information, in addition to being issued a citation, how much would they likely be fined?
   a. $500
   b. $5,000
   c. $1,000
   d. $1,500

10. What are the unique duties of a licensee in a single agency relationship?
    a. Dealing honestly and fairly, accounting for all funds, and disclosing all known facts
    b. Presenting all offers and counteroffers, limited confidentiality
    c. Confidentiality, obedience, loyalty, and full disclosure
    d. Using skill, care, care and diligence
11. A licensee attempts to negotiate a rental for a fee paid by the tenant. If the tenant applicant does not like any of the rental properties available, what are they entitled to request with 30 days of the contract date?
   a. 100% refund of the fee paid
   b. 75% refund of the fee paid
   c. One month’s rent in a comparable apartment
   d. Nothing. There is no refund.

12. Florida statutes require that a licensee report to the Commission within 30 days after being convicted, found guilty, or entering no contest or guilty to a crime. The penalty resulting from a first violation of this law is NOT likely to include which of the following disciplinary actions?
   a. A fine ranging from $250 to $1,000
   b. Probation
   c. License suspension
   d. A full disciplinary hearing

13. A sales associate receives a deposit check from a buyer on Tuesday. When must the sales associate deliver the deposit to the broker?
   a. When the seller accepts the contract
   b. When the buyer says the check is good and the funds are available
   c. By the end of the business day on Friday
   d. By the end of business day on Wednesday

14. Who is the sales associate’s employer?
   a. Buyer
   b. Seller
   c. Customer
   d. Broker

15. A licensee is required to provide written disclosure, which specifies the nature of the relationship they have with a member of the public. Which relationship does not require such disclosure?
   a. Single agent
   b. No brokerage relationship
   c. Transaction broker
   d. Individual
The question of what a property is worth is a key factor in real estate property decisions. Sellers want to know what their property is worth. Buyers want to know how a potential purchase compares to other properties on the market. Lenders are concerned with the value of a property as security for a loan. Others involved in real estate, such as tax assessors and insurance agents need information about a property’s value to assess taxes and insurance needs.

Accurately estimating a property’s value requires an understanding of numerous factors that affect value. Real estate licensees should have a solid understanding of the process appraisers use to arrive at a property’s value. You should also have a solid background in the principles of researching and completing a comparative market analysis (CMA) of a parcel of real property.

This chapter provides information about the different types of property value, three methods that appraisers use to estimate the value of a property, and the steps you must take to complete a CMA.

After completing this chapter, you should be able to do all of the following:

- Know when an appraisal is required
- Distinguish between an appraisal, a comparative market analysis (CMA), and a broker's price opinion (BPO)
- Identify the different types of value
- Identify the different appraisal principles
- Discuss the steps in the appraisal process
- Describe the three approaches to estimating value used by appraisers
- Know the steps for performing a CMA
- Identify the specific information needed when performing a CMA

In the early 1980s, banks and savings and loan associations in the United States went through a period of instability, with many institutions failing financially. Although there were many reasons associated with these failures, part of the responsibility was placed on the appraisal profession for preparing faulty appraisals. Congress subsequently passed sweeping legislation designed to correct many of the problems discovered during hearings into the collapse of lending institutions in the United States. This legislation was titled the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).

Title XI of FIRREA was directed toward the appraisal profession and required that appraisals utilized by federally regulated lenders in federally related transactions be developed and reported in conformity with the Uniform Standards of Professional Appraisal Practice (USPAP).
A federally related transaction is any real estate related financial transaction that a Federal Financial Institution Regulatory Agency (FFIRA) has either contracted for or regulates, and requires the services of an appraiser. Appraisal reports involving a federally related transaction must be prepared by a state certified appraiser.

All appraisals used in a federally related transaction must be prepared in compliance with USPAP by appraisers who are registered, licensed, or certified under Part II of F.S. 475. The Florida Real Estate Appraisal Board (FREAB) administers Part II of F.S. 475.

**APPRAISALS VS. CMAS**

As introduced in Chapter 1, appraising is the process of developing an opinion of value of real property. An appraiser conducts an independent, impartial, and objective analysis based on research and data pertaining to the value of the specified real property. Appraisal fees are based on the time, effort, and expense involved for completion of the assignment, not on the value of the property.

A variety of situations may call for an appraisal. Lenders may require an appraisal to determine whether the value of property being used as collateral for a loan is adequate. Situations such as federal income tax claims, federal estate taxes, real estate tax assessments, eminent domain, investment planning, insurance claims, and many other circumstances may require an appraisal or some other type of valuation service.

Real estate licensees may perform an appraisal under the real estate license law if the valuation is not to be used in a federally related transaction. However, real estate brokers and sales associates who offer opinions of value of real property usually do not perform an appraisal when arriving at an estimate of value. Instead, they prepare what is known as a comparative market analysis (CMA), which is a value estimate based on recent sales of similar properties in the same neighborhood. The comparative market analysis, frequently called a CMA, utilizes many of the appraisal concepts. However, a CMA may not be referred to as an appraisal.

**VALUATION**

Valuation is the process of determining the value of real property as of a given date. Value is defined by USPAP as an opinion of the worth of a property at a given time in accordance with a specific definition of value. It is the monetary relationship between properties and those who buy, sell, or use those properties. In appraisal practice, value must always be qualified (e.g. market value, liquidation value, or investment value).

There are a number of different types of value. An appraisal or a CMA will reflect the type of value that is sought by the client.

**Types of Value**

The more common types of value are as follows:

- **Assessed value** is the value assigned by the property appraiser for ad valorem tax purposes.

- **Investment value** is the value of a particular property to a particular investor. Potential purchasers of income-producing properties commonly request investment value appraisals. Investment value is the highest price an investor will pay for a property and the lowest price the seller will accept. Investment value is the value to a specific individual, while market value is the value in a typical transaction to a typical buyer.
• **Insured value** is the face amount that a casualty or hazard insurance policy will pay in the event that a property is judged unusable.

• **Liquidation value** is the amount that remains after all assets of a business have been sold in a hurried, but not forced, sale and all liabilities have been paid. It is the value of a failing business that is not expected to continue. It can also be used to estimate the minimum value of a profitable business. Liquidation value is typically estimated for financial institutions that are considering foreclosure on a property.

• **Market value** is the most often estimated value in real estate valuation. Market value is the amount that should be paid for a property, but not necessarily the amount which is asked or actually paid. Market value can be higher or lower than the cost or price. The definition below, taken from USPAP\(^1\), is the most widely accepted definition and is the basis for most appraisal reports.

  "Market value is a type of value, stated as an opinion, that presumes the transfer of a property (i.e., a right of ownership or a bundle of such rights), as of a certain date, under specific conditions set forth in the definition of the term identified by the appraiser as applicable in an appraisal.

  **Comment:** Forming an opinion of market value is the purpose of many real property appraisal assignments, particularly when the client’s intended use includes more than one intended user. The conditions included in market value definitions establish market perspectives for development of the opinion. These conditions may vary from definition to definition but generally fall into three categories:

  1. The relationship, knowledge, and motivation of the parties (i.e., seller and buyer);
  2. The terms of sale (e.g., cash, cash equivalent, or other terms); and
  3. The conditions of sale (e.g., exposure in a competitive market for a reasonable time prior to sale)."

• **Use value** (also known as **value-in-use**) of a property is the value the property holds for the owner. Several factors contribute to this value, such as:

  o **Income.** Property can produce income through leases. This is important because investors will pay for the income flow that ownership brings them.

  o **Appreciation.** Property generally increases in value over time. This is another investment benefit for an owner.

  o **Use.** The specific use of a property (residential, agricultural, commercial, or recreational) determines its value and its benefits.

  o **Tax benefits.** Property ownership could yield benefits in capital gains, tax losses, tax deferrals, and depreciation for an owner.

Price vs. Value

As opposed to value, price is the amount, which is actually paid in a real estate transaction. It is not necessarily the asking amount or amount offered, and may not represent the actual market value of the property. It may be more than, or less than, the market value. It is, nonetheless, the amount that the buyer is willing to pay and the amount the seller is willing to accept.

Example:

If a seller is forced to sell because of a job transfer, the property could sell well below market value. On the other hand, a property could sell above market value if the price of the property includes personal property, or if a buyer is willing to pay more for the property based upon some personal special circumstance.

Appraisal Principles

Many factors can influence the value of property. Appraisal principles are the rules that govern the formation of value and help to explain how and why values change in the market. Appraisers use them to assist in arriving at their value conclusion.

- **Principle of anticipation.** The principle of anticipation states that the value of a property today is the sum of its future benefits. When a potential buyer considers the purchase of a property, the benefits it will provide during that owner’s period of ownership forms the basis for the decision to buy, and at what price. Value today is measured in terms of future benefits. This principle is particularly visible in the purchase of income-producing real estate where present dollars are paid in exchange for the right to receive future dollars.

  Example:

  A buyer hears that the property down the street may become a shopping mall. Is that a benefit or a disadvantage? It may depend on the buyer’s viewpoint.

- **Principle of change.** The principle of change states that circumstances can cause changes to occur in the market, which in turn may affect the value of real estate. An appraisal is made as of a specific date in order to take into account the market forces that influence value at that point in time.

  An appraiser needs to keep abreast of the following types of changes that can have an effect on the value of real estate:

  - Volume of inventory
  - Rate of sale or time on the market
  - Forces of supply and demand
  - Interest rates
  - Availability of financing
  - Unemployment rates

  Example:

  Using our shopping mall example from above, is the construction of a mall a benefit or a detriment to the property’s value? Again, it may depend on the buyer’s viewpoint.
• **Principle of competition.** The *principle of competition* recognizes that sellers compete with other sellers, and buyers compete with other buyers. This principle focuses on the effect of changes in supply and demand. Factors affecting supply and demand include:

  o The number of properties available in an area
  o Property prices
  o Number of prospective buyers
  o Price buyers are willing to pay

**Example:**

If there is only one home available in a highly desirable neighborhood, that home would probably have more value than it would if there were four homes for sale in that same neighborhood.

Several fast food chain restaurants located on the same major street attract more buyers than one fast food restaurant would if it sat by itself.

• **Principle of conformity.** The *principle of conformity* states that the value of a property is sustained when it is in conformity with other properties in the same area. Conformity refers to size, architectural style, and other features.

**Example:**

If a three-bedroom, one-bath home is in a neighborhood where all the homes have two bathrooms, it might be wise for the owner to consider installing a second bathroom.

• **Principle of contribution.** The *principle of contribution* states that the value of a component of the property is the amount it increases the total value of the property; in other words, the amount by which the value of the property would decrease by its absence. This principle illustrates the difference between the cost of a component and the value added by the component. A *contribution* is what the market recognizes as the change in value that an improvement makes to a property, rather than what that improvement actually costs.

**Example:**

A remodeled kitchen might add $50,000 to the value of a home, while the actual cost could have been anywhere from $25,000 to $75,000. The contribution value of the remodeled kitchen is $50,000, not $25,000 to $75,000.

A pool may cost $30,000 to install on a property, but only add $15,000 to the property value. Therefore, the contribution value of the pool is $15,000, not $30,000.
- **Principle of progression.** The *principle of progression* applies when a lower-priced property is built in an area that consists of more expensive property. The lower-priced property will progress (increase) in value toward the level of the more expensive properties in the area. This principle tends to create price conformity within an area.

  **Example:**

  The value of the smallest house on the block will tend to increase if the other homes on the street have more value.

- **Principle of regression.** The *principle of regression* applies when a higher-priced property is constructed in an area which consists of lower-priced properties. The higher-priced property will regress (decrease) in value toward the level of the less expensive properties in the area. This principle, like the principle of progression, tends to create price conformity within an area.

  **Example:**

  The value of the largest house on the block may decrease if the other homes on the street are much lower in value.

- **Principle of substitution.** The *principle of substitution* recognizes that no one would pay more for a property than the amount necessary to acquire an acceptable substitute. This principle is the basis for all mathematical methods which are used by appraisers to estimate value.

  **Example:**

  If there are several homes for sale in a neighborhood and they are alike in size, quality, and amenities, a buyer, usually, will not purchase the home with the highest price.

**Appraisal Purpose and Intended Use**

The purpose of an appraisal and its intended use are distinct, as defined below.

- **Purpose.** The *purpose* of an appraisal is to estimate some type of defined value. As discussed, there are many different types of value, each of which has a definition of its own. Purpose relates to the work the appraiser was retained to perform, that is, to estimate some type of value. Most appraisals are performed to estimate market value.

- **Intended use.** The use or uses of an appraiser’s reported appraisal, opinions and conclusions, or other valuation services by the appraisal client is referred to as its *intended use* (previously referred to as *function* in USPAP). For example, the client may use the appraisal to decide whether to sell or not, to buy or not, and at what price. A lender may use the appraisal to decide whether a loan should be made or not by using that property as security.
THE APPRAISAL PROCESS

Appraisers follow a defined appraisal process when developing and reporting their opinions and conclusions in an appraisal assignment. The appraisal process is accomplished by following specific steps, the number of which depends on the nature of the appraisal assignment and the data available to complete it. In all cases, however, the valuation process provides the model to be followed in performing market research and data analysis, in applying appraisal techniques and in integrating the results of these analytic activities into an opinion of value.

The steps, in the order in which they are performed, are outlined below.

Step 1  Problem Identification

An appraiser must gather and analyze information about those assignment elements that are necessary to properly identify the appraisal problem to be solved. Communication with the client is required to establish this information. Identification of the problem to be solved requires the appraiser to identify the following assignment elements.

- The client and any other intended users
- The intended use of the appraiser’s opinions and conclusions
- The type and definition of value (purpose)
- The effective date of the value estimate
- Characteristics of the property that are relevant to the type and definition of value and intended use
- Assignment conditions and assumptions

Step 2  Scope of Work

The appraiser must determine the type and extent of research and analyses in the appraisal assignment that is necessary to develop credible assignment results. Determining the scope of work is an ongoing process in an assignment. Information conditions discovered during the course of an appraisal assignment might cause the appraiser to reconsider the scope of work.

Step 3  Data Collection and Analysis

The primary activity of the appraisal process is the selection, gathering, and analysis of data. In this step, data is collected and assembled for use. Data analysis occurs throughout the appraisal process. As data is collected, it is selected and analyzed for accuracy and relevance (reliability).

Data falls into two types:

- **General data.** General data concerns the region, neighborhood, economy, and so on.

- **Specific data.** Specific data is information about the subject property and potential comparable properties to be used in the analysis.
Chapter 3

Highest and Best Use Analysis

Every property has a single use, which produces the greatest income and return. Therefore, the property will have its highest value when it is used for that purpose. A highest and best use analysis indicates whether the existing improvements contribute to the value, or if they should be removed to permit a more profitable use. It also needs to be determined if the alternative use would provide a greater return on the investment.

For this analysis, the property’s use must be one or all of the following:

- Legally permissible
- Physically possible
- Financially feasible
- Maximally productive

Example:

A property that contains an old office building may not be in its highest and best use if it is located in a downtown area that is undergoing a residential redevelopment. Its best use might be a conversion to high-end condominium units.

Apply the Three Approaches to Value

There are three mathematical methods that appraisers can employ to estimate the value of a subject property. All three are employed to the extent that they are applicable, unless the assignment does not require one or more of them to be used. The three methods are:

1) The cost-depreciation approach
2) The income approach
3) The comparable sales approach

Each approach yields slightly different results, which must then be reconciled. Each of these approaches is discussed later in this chapter.

Reconciliation of the Value Indications and Final Opinion of Value

After the three approaches have been applied and each has resulted in a value estimate, the three estimates are compared. The appraiser’s confidence in the data and the appropriateness of the approaches to the assignment are weighed. Greater weight is given to the approach that the appraiser feels best reflects the value of the subject, and then a final value is estimated. Weighing the evidence and arriving at a final value conclusion is based on the appraiser’s knowledge, experience, and training. It is not accomplished by averaging the values or using a mathematical process.

Report the Defined Value

The objective of the appraisal is to answer the client’s original question with regards to the value of the rights specified in the subject property. Once the final value estimate has been estimated, the appraiser prepares a report, which is to be delivered to the client. Although there are legal and technical aspects to the way in which appraisals are performed and appraisal reports are prepared, they can be categorized as a form, narrative, or an oral report as defined below.
• **Form reports.** *Form reports* are used in millions of appraisals each year. Most primary lenders and the secondary market require them. The use of a form standardizes the way in which information is reported and it facilitates the underwriting process. This is the reporting preference for most residential appraisals.

• **Narrative reports.** *Narrative reports* are very comprehensive. They provide the client with the reasoning and conclusions of the appraiser in a detailed report that can contain as many as 50 to 300 or more pages. The length and content can vary depending on the nature of the assignment and the requirements of the client.

• **Oral reports.** *Oral reports* are generally given only in connection with court testimony. Appraisers who provide court testimony must follow the same procedures that are used to prepare written reports and must maintain files that support their conclusions and testimony.

### APPROACHES TO ESTIMATING VALUE

When performing a formal appraisal, appraisers typically use three approaches to estimating the value of property.

- Cost-depreciation approach
- Income approach
- Comparable sales approach

All three approaches are used by the appraiser if the assignment, the available data, and the requirements of the client do not limit their application. Each yields slightly different results and tends to give a more reliable estimate for a particular property type. The differences must be reconciled into a final value conclusion.

#### Cost-Depreciation Approach

The *cost-depreciation approach* is used to estimate the current cost of reproducing or replacing a building, minus an estimate for depreciation, plus the value of the land. This approach is also based on the principle of substitution. No one would pay more for an existing property than the cost to purchase land and have comparable improvements constructed on that land, assuming no unusual time delay. The value of the subject property can be estimated by using either replacement cost or reproduction cost. Both are defined below.

- **Replacement cost.** The *replacement cost* is the estimated cost at current prices to construct a comparable building with equal utility to the subject building by using modern materials, design, and features. A replacement building is not necessarily constructed with the same materials as the subject property. Some construction methods and materials may no longer be available; therefore, substitution may be necessary.

- **Reproduction cost.** The *reproduction cost* is the estimated cost to construct at current prices an exact duplicate or replica of the building, which is being appraised by using the same materials, design, and layout as the subject property. Reproduction cost is preferred in appraisals of historic properties.
The cost-depreciation approach is best used to estimate the value of newer properties, property proposed for renovation, insurance purposes, and properties infrequently exchanged or sold in the real estate market. The cost-depreciation approach may be the only approach available to estimate the value of special-purpose facilities, such as schools and churches.

**Income Approach**

The *income approach* is used to estimate the value that the property’s net earning power will support. This approach is based on the assumption that the value of a property is related to the amount of income that it can produce in the future. It is based on the appraisal principles of substitution and anticipation. The principle of anticipation states that the present value of a property is based on the benefits it can produce and its future income. Investors use this approach to determine how much they will pay for an apartment building, office building, shopping mall, or other income-producing property.

Two techniques that can be applied for the income approach are direct capitalization and gross multiplier.

- **Direct capitalization.** *Direct capitalization (or capitalization rate)* is a mathematical process in which future income is converted into a present value. This technique is not used to value one- to four-family rental properties.

- **Gross multiplier technique.** A *gross multiplier technique* uses gross rent or income instead of net operating income to estimate the value of one- to four-family rental properties. A gross rent multiplier (GRM) is applied for monthly rental properties. A gross income multiplier (GIM) is applied for properties with annual gross rental income. Most markets use a monthly GRM, but some areas prefer to use an annual GIM.

**Comparable Sales Approach**

The *comparable sales approach* is used to estimate the value indicated by the recent sales of comparable properties in the market. This approach is a direct application of the principle of substitution. The principle of substitution states that if similar or comparable properties are available for sale, the one with the lowest price will attract the greatest demand. The price at which a property will most likely sell is closely related to the price at which similar properties in the same market have previously sold. The comparable sales approach requires an active market. If no sales have occurred, this method is not applicable. Conversely, this method is appropriate for any type of property where sales have occurred.

This approach is usually the most applicable method for appraising residential properties. It is the basis for the value estimates, which are used by real estate brokers and sales associates in listing and selling real estate. A sales associate should focus much of their attention on this approach, as it will be used virtually every day in the practice of their profession.

Because of its relative simplicity and reliability, the real estate industry has modified the sales comparison method into the CMA that licensees use today.

**THE COMPARATIVE MARKET ANALYSIS (CMA)**

Developing a comparative market analysis (CMA) is a critical part of success for any licensee when working with sellers. Today’s market is extremely competitive and
complex; therefore, we cannot overstate the importance of appropriately pricing the
property. The CMA is an opinion of value based on current market conditions.

You must be careful never to refer to the CMA as an appraisal. Florida law permits a
licensee to prepare an appraisal as long as it is performed in conformance with USPAP,
but it is highly discouraged. In order for an appraisal prepared by a licensee to be valid, it
cannot be used in a federally related transaction; almost all transactions are federally
related.

**Example:**

If there is a mortgage involved, the lender is FDIC insured and the loan will be
sold on the secondary market, both of which make the transaction federally related.
Even if it is an all cash transaction, the value of the property cannot exceed
$250,000. In addition, the licensee is required to follow the USPAP.

As the licensee, you must establish the market value of any property prior to placing
it on the market. Today's real estate market is extremely competitive and proper pricing
is crucial to the sale of the property. As a rule, no marketing and advertising you might
do will sell an overpriced listing in today's marketplace.

To have true market value, the following assumptions are critical:

- Both buyer and seller are acting in their own best interest.
- The seller can convey marketable title to the buyer.
- Neither party is under duress or compulsion.
- The property has been available on the market for a reasonable time.
- Payment is in U.S. dollars or the cash equivalent.

True market value assumes all of these conditions exist simultaneously. However, they rarely do.
When preparing a CMA, you should consider the following principles of value:

- Substitution
- Change
- Competition
- Conformity
- Contribution

**Preparing the CMA**

For the residential real estate practitioner the comparable sales approach to value is
the method of choice for preparing a CMA.

The comparable sales approach to value is the direct utilization of the principle of
substitution. If there are multiple properties available for sale, the one with the lowest
price will create the greatest demand. The sale price of any property will be closely
related to those that have recently sold and are most similar to the subject property.

When preparing a CMA, the value must be based on recently sold properties.

In preparing the CMA, you should focus on using recently sold properties, usually
those sold within the last six months. In today's volatile market where short sales and
foreclosed properties have an impact on market value in many areas, you might be best
served by using properties that have sold within the last three months, if available.
Comparative Market Analysis Steps

As with appraisals, doing a proper CMA consists of following certain steps, which are listed and explained in further detail next.

1. Gather and evaluate information about the subject property. When doing a CMA, the seller’s property is referred to as the **subject property**.
2. Select similar properties in the area. Any properties that have characteristics similar to the subject property are referred to as **comparables**.
3. Compare the subject property to the chosen comparables and adjust the value of the comparables.
4. Determine an approximate and realistic selling price for the subject property.

**Step 1  Gather Information about the Property**

When collecting data about the subject property for analysis, you should concentrate on information about the neighborhood, the home site, and the existing property features. Advise your customers to access the internet for subjective information regarding the quality of the local schools, hospitals, police and fire departments, and crime rates.

**Neighborhood Aspects**

- **Access.** The proximity of the property to highways, shopping malls, employment areas, parks, etc.
- **Community amenities.** Certain features may add value to the community, such as clubhouse theatres and party rooms with kitchens, tennis courts, putting greens, swimming pools, etc.
- **Community status.** Is the neighborhood thought to be prominent compared to other nearby communities? Prominent neighborhoods are likely to have higher property values.
- **Consistency.** How similar are the homes in the neighborhood in relation to style, age, size, and quality? Zoning codes and restrictions, when enforced, can have a considerable effect on protecting the values of the properties.
- **Current land use.** Is the neighborhood in transition from a residential area to some other primary use? Depending on what use the area is transitioning to, values of existing property can be on the upswing or the downswing.
- **Government issues.** Do the current zoning codes protect the property from the entry of non-residential uses? Also, pull together the property tax information and compare it with neighboring communities.
- **Land contour.** How does the land topography compare with other neighborhoods? Variations in the topography are more attractive than areas that are totally flat or steep and hilly.
- **Nuisances.** What nearby annoyances could potentially lower the property’s value? Annoyances include odors, industrial noise, pollution, smog, fog, or unsightly views.
• **Ownership makeup.** Are most of the homes in the area owner-occupied or are there many rental properties? Owner-occupied homes tend to be in better shape and have less wear and tear.

• **Public services.** Is there public transportation available in the area? Also, obtain information about the location of the police and fire department protection units.

• **Schools.** What schools are in the neighborhood and what are their reputations? Are the schools within walking distance of the property? Many buyers put school quality at the top of their priority list when looking for a new home.

• **Streets.** How well are the streets maintained? Check the width of the streets. Wider streets are typically preferred over narrow, more crowded ones.

• **Utilities.** What utilities are available in the neighborhood? Utilities to consider are: electric, gas, water, sewers, telephone, cable TV, and Internet access.

• **Vacancies.** What percentage of homes in the area are unoccupied? Several vacancies could be an indicator that people are not interested in moving into this neighborhood.

**Home Site Aspects**

• **Area.** What is the total square footage of the lot? If the lot is substantial, the area may be given in acres rather than in square feet. Sometimes, when two adjacent pieces of property are joined together (*assemblage*), the value of the one larger parcel may be greater than the value of the two separate ones. This is more commonly referred to as *plottage value*.

• **Depth.** What is the *depth of the property*? This is the measurement of the distance from the front boundary to the boundary at the back of the site. Sometimes, a deeper lot is thought to be more valuable, but that is not always true. Each lot should be evaluated individually to make that determination.

• **Frontage.** What is the *frontage measurement*? This measurement is the length of the front boundary of the property, either along the street or along a lake, river, or other body of water. If the frontage is significant, it can raise the value of the property, especially if it provides access to a desirable feature. Special assessments are based on the frontage along the street. If any special assessments are currently being planned or are imminent, the new homeowner could be faced with additional costs soon after the purchase.

• **Landscape.** Is the property gently rolling land, which is usually preferable to flat or hilly sites? If the site is a vacant lot and it would incur higher development costs because of the rolling terrain, therefore, the value of the lot would decrease.

• **Position and orientation.** What are the site’s features? Features might include the view, amount of sun or shade it receives daily, proximity to traffic noise, and the amount of shelter it receives or doesn’t receive from the elements.

• **Property width.** What is the *property width*? This is the lot’s measurement from one side boundary to the opposite side boundary. Be aware that this
measurement can differ. The width of a pie-shaped lot will be much smaller in
front than it is in the back and will change at all points along the way.

- **Shape.** Is the lot a rectangle, square, or some irregular shape? Standard shapes
  are generally thought to be more valuable than irregular lots because of their
  adaptability.

- **Title considerations.** Do you notice any evidence of easements or
  encroachments that could affect the title? Properties with existing easements
  could be considered less desirable or valuable than a similar property with no
  easements. Direct your clients to their selected title company in inquire about the
  existence of existing liens, easements, or physical attachments to the property.
  Advise them to find out about the legal standing of these encumbrances, and the
  limitations it will place on their use of the property if any.

**Example:**

An underground utility line could prevent the new homeowners from
installing an in-ground swimming pool in a desired location.

**Property Features and Improvements**

- **Age.** How old are the structures? Does their condition make the property look
  older or younger than its actual age?

- **Air conditioning.** Is the home air-conditioned? If so, does it have central air or
  window units? Air conditioning adds value to a home and, since most areas of
  the country have at least some hot weather, most buyers consider it vital. In
  Florida, central air conditioning is considered a necessity.

- **Basement.** If the home has a basement, is it finished or unfinished? A finished
  basement adds value to a home, but usually not enough value to recover the
  cost of having made the improvement.

- **Energy efficiency.** What energy-saving features are in the home? This includes
  extra insulation, double- or triple-paned windows, and energy efficient
  appliances, such as hot water heaters, dishwashers, and heat pumps. Newer
  appliances and central air conditioning units usually carry the highest efficiency
  ratings and may add considerable value.

- **Home size.** What is the square footage of the home’s living area? This does not
  including attached garages, unfinished basements, or porches. Most often, the
  **living area** must be under heat and air-conditioning.

  **Note:** Home size is one of the most important factors that affects price. Many
  jurisdictions have very specific standards for measuring living areas, which
  regulators require licensees to follow. You should be aware of any measurement
  standards in your area before finalizing any square footage estimate in your
  CMA.

- **Interior home design.** Is the floor plan efficient and convenient with an attractive
  layout? Are there any design flaws that could lessen the home’s value? Design
  flaws are referred to as **functional obsolescence.**
Parking facilities. If the home has an enclosed garage, how many cars can it hold? Is the garage space big enough for storage and/or a workshop in addition to the parking area? Is there a doorway that goes directly from the garage to the home’s living area? If the garage is detached, is there a covered walkway or other way to get from the garage to the house and stay protected from the weather? If there is no garage, is there a carport? A carport is less valuable than a garage, but more valuable than no protection at all.

Quality of construction. What types of materials were used in the construction of each of the buildings? Is the quality of the materials good, fair, or poor? This is especially important in the kitchen and bathrooms.

Total number of bathrooms. How many full baths, three-quarter baths, and half-baths are in the home? A full bath has a sink, toilet, and tub, and may or may not have a shower. A three-quarter bath has a sink, toilet, and shower, with no bathtub. A half-bath has only a sink and toilet.

Total number of bedrooms. How many bedrooms are in the home? Bedrooms add considerable value to a home. If all other home features are equal, a three-bedroom home is worth much less than a four-bedroom home. The value of bedrooms depends on the area in which the home is located. In a retirement community, for instance, a two-bedroom may add significantly more value than a four-bedroom home. In a family community with children, additional bedrooms may add significantly more value than in a retirement community.

Total number of rooms. How many rooms are in the home, not including the bathrooms or any rooms in the basement?

Select the Comparable Properties

A good comparative property should be as similar as possible to the subject property, the one that you are valuing. It should also be an arms-length transaction. Which means a transaction in which the buyer and seller were unrelated and acting in their own best interest.

Areas of similarity should include:

- Size of lot
- Design
- Square footage
- Location
- Age
- Improvements
- Style
- Pool
- Physical condition
- Number of rooms
- Garage
- Amenities

You should choose at least five to six comparables for the CMA; eight to ten would be better, if available. This number can be reduced by assigning a weight to each comparable property. The more similar the comparable is to the subject property, the greater the weight.
You should choose comparable properties from those that have sold recently, those whose sales are pending, those whose listings are currently active, and those whose listings have expired. There are good reasons for choosing properties that fall into all of these categories, as explained below.

**Recently Sold**

Comparable properties that have recently sold are probably the best predictor of the market value of the subject property. Since the transactions have closed and the seller has received his or her cash, it is safe to assume that the selling price was arrived at mutually by a willing seller and buyer.

This list of properties should include similar properties that have sold within the past three to six months. The more recent the sale, the more reliable the data. If it is necessary to go back more than six months, you should make inflationary adjustments. Usually, though, there are too many variables involved to use comparables that were sold longer than 12 months ago.

You should include a minimum of three properties in this category if possible. If there isn’t enough data available, you may have to increase the time period. However, keep in mind that the further back the sales go, the less reliable the data becomes, and the more adjusting you will have to do to account for changes in the market over that time period.

The list of recently sold properties shows the actual sales price for the property. It also shows the original listing price and the days on the market, which gives information about how competitive the home was in the marketplace at the time. Interestingly, appraisers only use data from sold properties when performing appraisals.

**Pending Sales**

A *pending sale* is an offer that has been submitted by a buyer and accepted by a seller, but neither has the sale closed nor the title transferred. Sales generally stay in the pending stage for 30 to 60 days. Keep in mind that the information on pending sales is not as reliable as on sold homes, for these reasons:

- The price you see on the pending sale is the listing price, not the final sale price. The definite sale price of the home is not available until the sale actually completes. Many times the sale price is somewhat lower than the listing price, or it may even be higher.

- The sale is not complete until the closing takes place. In other words, something could still happen to overturn the sale, even up until the very last minute. A home inspection can raise all kinds of issues, or either party to the transaction could simply change his or her mind. The lender will ask the buyers to verify their employment just a couple of days before closing or may not approve financing.

If the pending comparable is a very close match to the home you are trying to list, you can contact the broker of the pending sale to see if the property closed at a price close to the asking price. The broker cannot give out the actual final price because that would be a violation of duties owed to the seller; however, he or she might be able to give enough general information to help you arrive at the list price.
Active Listings

Sellers are always interested in knowing the listing prices of the comparable homes currently for sale in their area. After all, the surrounding comparables are their competition. You need to present this information to the sellers along with sound advice from your experiences. You are out working with buyers in the market and you can give advice to the sellers from a buyers’ perspective, which can provide them with valuable insight. In other words, if buyers are looking to move into a certain school district or in a local community, that has lower tax rates, you should make your sellers aware of this to help them in pricing their property. Sellers need help in keeping their expectations realistic.

To help them do this, you might use the following strategies:

1. Emphasize to the seller that the current asking prices will be affected by the negotiations between the sellers and the eventual buyers of the homes. Seldom does a home sell at, or even close to, the original listing price. Statistics are available from your local MLS that show selling price-to-listing price percentages. If, for example, in your area that number is 96%, you should inform your seller.

2. Inform your seller about how many houses are on the market in their neighborhood, the asking prices, advantages and disadvantages of those listings compared to theirs, and the improvements they can make to their home to make it more marketable. Be sure to check the local county appraisers’ web site for homes that aren’t listed in the MLS. These homes may have sold without the help of a REALTOR®.

3. Clarify to the seller that while he or she has only one home to sell, the buyers have a number of homes from which to choose. They will tour many homes before and after they see your seller’s home. Ask your seller what features they think will make their home stand out among the competition. Make sure you inform the seller of the features of the sold listings in their neighborhood. One may have sold for a premium, but the reason for that could be that it was completely remodeled. In addition, one might have sold at a lower price due to a short sale or foreclosure.

Expired Listings

An expired listing is a listing for a home that did not sell. These homes are at the opposite end of the spectrum from the homes that sold.

A property fails to sell, most often, because of overpricing. Expired data may show the seller that the asking prices of these homes were significantly higher than the selling prices of the homes on the recently sold list. This is powerful information for you to share with a prospective seller. This information can support suggestions for a more realistic listing price. You can also argue that setting a too-high asking price will waste valuable time in obtaining the sale.

If you can find one, a particularly good example to share with a seller is an expired listing that had been re-listed and is now on the sold properties list. This will demonstrate very clearly how the home was originally overpriced and failed to sell, but, when re-listed at a price that was on target, sold readily.
Sample CMA Form

A sample CMA form that you could use when preparing the CMA for your prospective sellers is shown below. Many different formats are available.

![Sample CMA Form](image)

Adjust the Comparables

In a perfect world, all of the comparable sold properties would be exactly the same as the subject property; unfortunately, this never happens. Your goal is to select homes that are closest to the subject property in architectural design, age, condition, square footage, and location. It will be necessary to adjust the comparables to bring them in line with the subject property. The idea is to make the comparables like the subject property.

Once you have determined an estimated value for specific home features, you will either add or subtract those values from the sale or listing price of the comparables. When adjusting comparables, always adjust the comparable; never adjust the subject property. All adjustments are made to the comparable.

If a comparable lacks a feature that the subject property has, then add the value of the feature to the price of the comparable.

If a comparable has a feature that the subject property does not have, then subtract the value of that feature from the price of the comparable.

You can adjust the comparables by utilizing two different methods.

1. Matched Pair (or Paired) Sales Technique
2. Square Footage Technique
Matched Pair (or Paired) Sales Technique

The matched pair (or paired) sales technique entails estimating the value of various physical differences by locating other properties that have sold in the area, of which, one that has a particular feature you are trying to value and another one that does not. If that single item is the only difference between the two sales, then the theory says that the difference in the sale price of the two items can be directly attributed to the absence or presence of that item.

Of course, there may be other variables and the larger your sample, the more accurate the results.

Example 1:

You found a home with a swimming pool that recently sold in the area for $210,000. You also found a home that does not have a swimming pool, but is similar in other respects, that recently sold in the same area for $200,000.

You can assume that the $10,000 difference in the sale price is due to the pool. Furthermore, you can deduce that a pool is worth $10,000 in that area.

Example 2:

You found a home that is on a one-acre lot with a one-car garage that recently sold in the area for $126,000. You found another home that is on a one-acre lot with a two-car garage that recently sold in the same area for $134,000.

All other things being equal, you can assume that the $8,000 difference in the sale price is attributable to the larger garage.

Square Footage Technique

The square footage technique may very well be the most used method to adjust the comparables. It is easy to ascertain the sold price per square foot in any given area. In fact, most CMA programs will calculate the highest, lowest, and average price per square foot. Take the price per square foot of the sold properties and apply it to the subject property to arrive at a value of the property, or a value of an item, like a bedroom.

Example 1:

Several properties have recently sold in the area for $200.00 per square foot. The subject property is 2,500 square feet in size. Therefore, the value of the subject property is calculated to be $500,000. (2,500 sq. ft. x $200 per sq. ft. = $500,000)

Example 2:

The subject property is a four-bedroom, 2,300 square foot home. You found a very similar comparable property that is a five-bedroom, 2,800 square foot home. The extra bedroom represents a 500 square foot difference between the homes. (2,800 – 2,300 = 500) You can then calculate that the extra bedroom would be worth $100,000 (500 X $200.00 = $100,000).
Amenities

Adjusting for amenities or updates is an acquired skill. It can be very difficult to put a value on an updated kitchen or bathroom. You may want to start by using the top price per square foot for updated properties and using the average price per square foot for properties that are not updated.

Other Adjustments

Depending on circumstances, you might need to make any or all of several other adjustments. Some are listed below.

- Financing terms. The manner by which a property is financed can influence the price that a buyer is willing to pay for it. If very favorable terms are offered, a buyer may be willing to increase the offer. If only unfavorable terms are available, the buyer may decrease the offer.

- Conditions of sale. Market value assumes that neither the buyer nor the seller are under any undue influence and are acting in their own best interest.

- Market conditions. The market may have substantially changed since the time the comparable was sold. If so, the sale price of the comparable needs to be adjusted to reflect current market conditions.

- Location. If the comparable is located in a different neighborhood or location, you may need to adjust to compensate for that fact.

- Physical characteristics. You may need to adjust for differences in age, condition, lot size, number of garage stalls, bedrooms, bathrooms, and so on.

Adjust the Comparables Scenarios

Scenario 1: Determine an Adjustment

Mark, a broker, found a comparable in the same neighborhood as his subject property. Almost all of the factors are the same. The difference is that the comparable has three full bathrooms and the seller’s home has two full baths. The comparable sold for $250,000.

Because the comparable property has a feature that the seller’s home does not have, Mark needs to adjust the sales price of the comparable down to make up for the difference. How does he decide how much to adjust the price?

Until you have enough experience in the market to know the value of certain features, you will have to determine those values by comparing homes that have already sold. So, let’s look at how Mark can determine the adjustment for the bathroom.

Mark has found two homes, which have recently sold. Both comparables have three bedrooms, a formal dining room, a two-car attached garage, and a similar lot size. In fact, they are nearly identical, except that one home has four bathrooms and the other one has three. The home with four bathrooms sold for $267,500; the home with three bathrooms sold for $262,000. (A difference of $5,500.)

Since the bathrooms are the only feature difference, it’s safe to say that the $5,500 difference in the sale price is the value of the bathroom. By using this method, Mark knows that a full bathroom is worth $5,500.
Going back to our scenario, Mark can subtract $5,500 from the $250,000 selling price of the comparable to arrive at an adjusted sales price of $244,500. Mark can look at other sets of comparables to get some reasonable estimates of what different features, such as a bedroom, a three-car garage, a larger lot, or a separate formal dining room might be worth.

**Scenario 2: Adjust the Comparables**

Luke, a broker, has found three recently sold comparables for his subject property in Orlando. Comparable #1 sold for $262,000, comparable #2 sold for $247,250, and comparable #3 sold for $245,750. Using the information about the three properties, Luke can create a chart that will help him adjust for the differences in the properties and arrive at an estimate of a listing price to share with his sellers.

Look at the sample chart, which illustrates how Luke made the adjustments. Remember: if a comparable lacks a feature that the subject property has, then add the value of the feature to the price of the comparable. If a comparable has a feature that the subject property does not have, then subtract the value of that feature from the price of the comparable.

Based on the information found by adjusting the price of the comparables, Luke can recommend a listing price to his seller.

<table>
<thead>
<tr>
<th>Comparison Chart for Comparable Properties</th>
</tr>
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<tbody>
<tr>
<td><strong>Subject property</strong></td>
</tr>
<tr>
<td><strong>Sale price</strong></td>
</tr>
<tr>
<td><strong>Features</strong></td>
</tr>
<tr>
<td>Location</td>
</tr>
<tr>
<td>Lot size</td>
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<tr>
<td><strong>Adjustment</strong></td>
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<tr>
<td>Age</td>
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<tr>
<td>Style</td>
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<tr>
<td>Bedrooms</td>
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<tr>
<td><strong>Adjustment</strong></td>
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<tr>
<td>Bathrooms</td>
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<tr>
<td><strong>Adjustment</strong></td>
</tr>
<tr>
<td>Total rooms</td>
</tr>
<tr>
<td>Square feet</td>
</tr>
<tr>
<td>Exterior</td>
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<tr>
<td>Garage</td>
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<tr>
<td><strong>Adjustment</strong></td>
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<tr>
<td>Basement</td>
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<tr>
<td>Financing</td>
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<tr>
<td>Days on market</td>
</tr>
<tr>
<td><strong>Total Adjustments</strong></td>
</tr>
<tr>
<td><strong>Adjusted Market Value Price</strong></td>
</tr>
</tbody>
</table>
Determine a Realistic Selling Price

Step 4 is the process by which you determine the value of the subject property – or the realistic selling price. In the chart used in Scenario #2, you see that each comparable now has an adjusted market value price. Luke should use these figures to estimate the value of the subject property.

However, before Luke decides on an estimate, he needs to evaluate the soundness of each comparable. The most reliable comparables are those that are the most similar to the subject property. Most similar means the fewest number of adjustments.

In some cases, it may be necessary or beneficial to assign a weight to each comparable. The more the comparable looks like the subject, the greater its weight or importance in determining value.

In Scenario #2, Comparable 3 is the least reliable, since it has many adjustments. Comparables #1 and #2 are much more similar to the subject property, with Comparable #2 being the closest. Therefore, Luke would give the most weight to Comparable #2 and the least weight to Comparable #3.

Keep in mind that it’s not up to you to give the seller an exact listing figure. You would do best to offer the seller a listing range and then let the seller set the price to whatever he or she feels comfortable with within that range. Using our example above, Luke would suggest a listing price within the range of $245,000 to $263,000.

The seller does not set value; the market (speaking through past sales) sets the value. The seller can only set the asking price.

Short Sales, REOs, and the CMA

An abundance of distressed properties in a market will present some unique challenges in the preparation of the CMA.

When preparing a CMA, it is always preferable to select comparable sold properties that were not distressed properties. This may not be possible in an area with an abundance of distressed properties. In these scenarios, the distressed properties will affect market value. A seller may feel that his or her property is worth substantially more than other properties that have sold that were distressed, but this may not be the case.

Example:

If there have been ten or 15 distressed properties that sold for $150 per square foot and the properties with active listings are asking $150 to $160 per square foot, will the seller be able to sell for $250 per square foot? Of course, the answer is “No.” The subject property would never be appraised at this value. The distressed market sets value in many areas.

If the seller wants to sell, they must compete in the market that exists; this includes a market with distressed properties.
Broker Price Opinion (BPO)

A Broker Price Opinion (BPO) is an estimate of value for a property (real estate asset) owned by the bank. These properties are commonly referred to as Real Estate Owned (REO) properties. They are properties that were obtained due to foreclosure, or deed in lieu of foreclosure, or a short sale. The BPO is sometimes referred to as an automated valuation model (AVM) because it is usually submitted by computer.

A lender may hire a real estate professional to perform a BPO to help determine the selling price of the property since the licensee typically has knowledge of the local market. The licensee will be asked to take photos of the property and complete a BPO report form provided by the lender. The report includes a neighborhood analysis of comparable properties along with local and regional market information. Factors that will affect the price of the property in a BPO report are the values of similar surrounding properties, sales trends in the neighborhood, and the amount of repair needed to put the property up for sale. BPOs are less thorough than an appraisal, but require more analysis than a basic CMA.

Anyone who holds an active broker, sales associate, or appraisal license in the state of Florida may prepare a BPO. The preparer is entitled to receive compensation for the BPO.

With the unprecedented amount of distressed properties in the marketplace over the past few years, BPOs can be a viable source of income for you. To insure a steady source of BPO requests, you might be best served by having an established relationship with the bank’s asset manager, outsourcer, or a BPO company.

An outsourcer is an asset management company that handles the entire process from the time it is assigned to a broker to the sale. Many lenders choose not to handle the asset themselves so they turn it over to an outsourcer for handling.
CHAPTER 3 REVIEW QUESTIONS

1. Appraisals used by lenders in federally related transactions must comply with ________ and be performed by ________ who are registered, licensed, or certified under Part II of F.S. ______.

2. ____________ is the amount that should be paid for property, but is not necessarily the amount which is asked or paid. It is the value most often estimated in real estate valuation.

3. ____________ is the type of value that is specific to a particular investor. It is the highest price the investor will pay and the lowest price the seller will accept.

4. ____________ is the amount which remains after all assets of a business have been sold in a hurried sale and all liabilities have been paid. It is the value of a ________.

5. The principle of ____________ states that the value of a property today is the sum of its future benefits. This principle is visible in the purchase of ____________ property.

6. The principle of ____________ states that the value of a property component is the amount it ________ the property value when present, and ________ the property value when absent.

7. According to the principle of ____________, a buyer will not pay more for a home than what he or she will pay for another home that is similar in characteristics and amenities.

8. In the data collection and analysis step of the appraisal process, a ____________ analysis indicates whether the existing improvements contribute to the value, or if they should be removed to permit a more profitable use.

9. The ____________ approach to estimating value is used to estimate the current cost of reproducing or replacing a building and is most reliable for properties that were built recently.

10. The ____________ approach is used to estimate the value of a property based on recent sales of similar properties in the market. This approach is a direct application of the principle of ____________.

11. When doing a CMA, the seller’s property is called the _____________. Properties that have similar characteristics that will be used for comparison are called _____________.

12. When collecting data about a property for a CMA, you should concentrate on obtaining information about the ____________, ____________, and existing _____________.

13. When adjusting comparables, you should always adjust the _____________; never adjust the _____________.

14. If a comparable lacks a feature that the subject property has, then ________ the value of the feature to the price of the comparable. If a comparable has a feature that the subject property does not have, then ________ the value of the feature from the comparable.

15. A lender may hire a real estate professional to perform a ____________ to help determine the selling price of a bank-owned property. This type of property is commonly referred to as a ____________ property.
CHAPTER 3 PRACTICE EXAM

1. A comparative market analysis (CMA) contains information about all EXCEPT which of the following items?
   a. Currently listed homes
   b. Recently sold homes
   c. Recently remodeled homes
   d. Similar expired listings that didn’t sell

6. When performing the data collection and analysis step of an appraisal, which of the following is NOT a condition for highest and best use analysis?
   a. Minimally productive
   b. Financially feasible
   c. Physically possible
   d. Legally permissible

2. Which of the following is the term used to describe the change in value that an improvement makes to a property?
   a. Competition
   b. Contribution
   c. Change
   d. Conformity

7. Which property would not be a good choice as a comparable property when performing a CMA on a subject property?
   a. A recently sold property in the same neighborhood
   b. A pending sale down the street
   c. A property next door that sold over two years ago
   d. An active listing in a nearby neighborhood

3. Which of the following information about the subject property is NOT obtained as part of the first step of preparing a CMA?
   a. Neighborhood aspects such as schools, utilities, and community amenities
   b. Market aspects such as recent sales, pending sales, and active listings
   c. Home site aspects such as square footage, landscape, and easements that could affect the title
   d. Property features such as age, size, and number of bedrooms and bathrooms

8. Which of the following terms best describes the amount which is actually paid in a real estate transaction?
   a. Assessed value
   b. Cost
   c. Price
   d. Market value

4. Tim and Sue have the smallest home in a sought after neighborhood. The value of their home is increased because of the higher value of the other homes in the neighborhood. Of which appraisal principle is this an example?
   a. Regression
   b. Substitution
   c. Anticipation
   d. Progression

9. A lender requests an opinion of value for a bank-owned property. Which valuation method would most likely need to be performed?
   a. CMA
   b. BPO
   c. Appraisal by a licensed appraiser
   d. Appraisal by a real estate licensee

5. Which principle of value is the comparable sales approach based on?
   a. Anticipation
   b. Competition
   c. Substitution
   d. Highest and best use

10. Which property would most likely be appraised using the income approach?
    a. A church
    b. A single family, owner-occupied home
    c. A single family home proposed for renovation
    d. An apartment building

11. What should you give to the sellers to help them set a realistic listing price with which they can feel comfortable?
    a. A listing range
    b. An exact listing price
    c. A list of similar properties
    d. An appraisal of their property
12. The subject property in a CMA has four bedrooms and three bathrooms. A good comparable property has four bedrooms, but only two bathrooms. A bathroom is valued at $5,000. Which adjustment should be made?
   a. Make no changes to the price of the comparable.
   b. Add $5,000 to the price of the comparable.
   c. Throw the comparable property out of the analysis.
   d. Subtract $5,000 from the price of the comparable.

13. Why would you perform a comparative market analysis?
   a. To establish an average base price.
   b. To discover why some homes have not sold.
   c. To identify the listed value of homes.
   d. To identify an estimate of a property’s value based on comparable sales.

14. Why is the information on pending sales not as reliable as the information on sold homes?
   a. It is totally based on the seller’s opinion.
   b. Almost all pending sales are outdated.
   c. They only indicate market value.
   d. The price shown is the listing price, not the sales price.

15. Which type of value is assigned by the property appraiser for tax assessment?
   a. Assessed value
   b. Investment value
   c. Market value
   d. Use value
PROSPECTING

Prospecting is the very foundation of your real estate business. Buyers, sellers, closings, and commissions all stem from prospecting. **Prospecting** is the process of looking for new business; this process never stops. In fact, you should spend a majority of your time on prospecting for business. If you understand this concept and develop a truly aggressive and consistent prospecting plan, you will ensure the success of your real estate business.

There are three keys to prospecting success.

- **Number of contacts.** Simply put, it’s all about the numbers. The more people you put your name in front of, talk to, or meet in person, the more business you will do. Who do you think will do more business, the broker who contacts a hundred people or the one who contacts a thousand? The answer is obvious.

- **Consistency of contacts.** Yes, it’s all about the numbers, but that must include consistency. Consistency means two things in prospecting. First, you must prospect each day; prospecting never stops. Second, prospect to the same people consistently. Doing so will increase your rate of return. Repetition is critical. The more times a person sees or hears your name, the more likely they will call you.

- **System for tracking contacts.** As you prospect, it’s essential to keep track of and organize all the information you obtain about your target prospects. You need to have a tracking system in order to control the information you collect. We refer to this as your database and it will enable you to retrieve and utilize the information at will in your prospecting efforts.
**Your Database**

Information management plays a key role in allowing you to achieve all three of the keys to prospecting success. The better you manage your data, the more successful you will be. Technology enables you to manage and access large amounts of information. Contact management software and mobile applications are available to provide quick access to your information from your computer, iPad, or other mobile devices. The more automated you make the prospecting process, the more people you can reach on a consistent basis, with less time and effort.

When setting up your contact management software, start with five categories and create a separate database for each.

- **Sphere of influence.** You should start with your sphere of influence database. Start by compiling a list of all the people you know and with whom you have ever interacted. This includes friends and family, your hair stylist, auto mechanic, doctor, lawyer, accountant, favorite server or bartender, members of civic organizations, clubs, sporting events, and school acquaintances. Literally, this list should include everyone you can think of.

  This may be somewhat overwhelming and time-consuming in the beginning, so you might begin by inputting ten people every day until you have entered your complete list. Of course, this list will grow over time as you meet and interact with new people, so just add them to your database as you meet them.

  A good prospecting technique is to tell potential customers that you are always looking for new business. Ask if they mind if you add them to your prospecting list. You can tell them that you are always looking to increase your business and you could use their help. When asked, most people love to help someone they admire and trust. We need to make sure that the people in our sphere of influence regard us in that light.

- **Expired listings.** Expired listings are listings for properties that were placed on the market, but failed to sell. Working with expired listings gives you a lot of power at the front end, because you start with a lot of information. You know what price the sellers were asking for the property, the commission that was offered, and the fact that they want to sell. Most importantly, the sellers are probably extremely motivated by now, since their property was on the market for several months previously. Every day, you should check the Multiple Listing Service (MLS) for expired listings in your market area and enter the information into your database for expired listings. You can automate this process through your MLS home page.

- **For sale by owner (FSBO).** For sale by owner (FSBO) properties are another great place to prospect for new business. With FSBOs, you know the sellers are already interested in selling, so all you need to do is convince them that you’re the one who can sell it for them. You can find FSBOs by driving through your market area looking for “For Sale by Owner” signs and by checking the real estate classifieds section of the local newspaper each Sunday. You can assume any property ad that does not display the name of a brokerage company is a FSBO property. Gather their information by checking the tax rolls and place the information in your FSBO database.
**Geographic farm.** A geographic farm area is a specific geographic location, subdivision, or area in which you choose to concentrate your activities. The idea is to establish yourself as the expert in that area or neighborhood, so that when those sellers think about real estate, they’ll think about you. The best farms tend to be homogeneous areas having similarly priced homes or sharing characteristics, such as age, family type, attitudes toward recreation, etc. When choosing a farm area, consider how you relate to the people in that area or group. If you are comfortable with and have a special interest in the area, you’ll more likely exert the effort you’ll need for success.

Once you’ve chosen a geographic farm, enter all of the information about the homes into your geographic farm database. You can automate this process by using the MLS system or the tax rolls in your local county tax appraiser’s office.

**Past clients.** Past clients are the best leads because you already have a past working relationship with them. You can think of it as “free business” since you’re getting the business from work you have already done. After completing a transaction, enter the sellers’ or buyers’ information, including their forwarding address, into your past clients database. Over time, the database will grow. It’s critical that everyone in your past clients database hear from you at least twice a year. Send them a postcard, anniversary of their purchase, birthday card, calendar, or other similar mailing. Be sure any communication you send contains your company’s name, your name and photo, and your contact information.

### Prospecting for Sellers

Listings are the foundation of a successful real estate career. The best way to find buyers is to have listings. As we discussed in the database section above, there are five sources for obtaining listing prospects. We have already defined each of the categories. Now, we will discuss how to utilize them in your prospecting efforts.

Since virtually all of your listings will come from one of these five sources, your business plan should focus on prospecting to these groups.

**Sphere of influence.** Make sure that everyone knows you are in the real estate business. There’s nothing worse than running into somebody you know only to have him tell you that he just listed with another broker because he didn’t know you were an agent. Tell everyone that you are in the real estate business and have the expertise to handle all of their real estate needs.

Start by calling persons in your sphere of influence to create that personal contact. Subsequently, direct mail is probably your best approach. You can be extremely creative with sphere of influence mailings, using postcards, property flyers, tri-fold brochures, refrigerator magnets, calendars, just listed / just sold cards, and other print pieces. The list is almost endless. However, be sure, as in all of your mailings, that there is some form of call to action followed by your phone number. A call to action tells the recipient what to do next.

**Example:**

Your postcard might end with the call to action phrase, “Call today for all of your real estate needs.”
Your sphere of influence campaign is exactly that, a campaign. It’s a never-ending process. In the beginning, the more frequently you send out mailings (including e-mail), the better the results. A good practice is to send a mailing at least once a month, and then, after three months, send one at least every 60 days. Support your direct mail campaign with two to three phone calls per year and a face-to-face meeting, if possible.

- **Expired listings.** Expired listings are easy to find because they are in the MLS system. You can automate the process by scheduling the MLS to send you the expired listings in your area of choice.

  To automate the MLS process, login to the MLS system and change the search criteria to the desired classification and type of properties. Examples of classifications might include residential new, residential pending, residential expires, residential back on the market, and residential price change. Types of properties might include residential single-family or condominium, townhouse, and villa.

  Once you’ve changed the criteria to your specifications, whenever you log into the MLS, it will automatically search the areas for your specific criteria and give you that information. If you have chosen to search for all of the expired listings in your area, then all of the expired listings in your area will appear.

  Enter the expired listings information into your database and start contacting those sellers consistently. Contact them approximately once a week until they relist the property, hopefully, with you. It’s a fact that approximately 98% of all expired listings are relisted with a broker. You want to be that broker.

- **For sale by owner (FSBO).** Gather information on FSBO properties by checking the tax rolls and then start prospecting. One approach includes sending letters to the homeowner. The letter includes helpful advice on selling the home. Another approach is to deliver a free packet of information to the homeowner that includes forms, helpful hints, and articles on selling, and sample settlement instructions. Some agents simply telephone for an appointment or knock on the door. The key to any approach you choose to use is to convince the homeowner that selling a home is complicated and that you could do it better and faster.

  Even if you are initially shy about contacting FSBOs, you may find it much easier if you have a specific buyer in mind. In such a case, you can call the owners and ask them for a one-party listing or a one-time showing contract. Since most owners would not be willing to pass up an opportunity for a prospective buyer to see their home, they will often give permission for the single showing. This will give you an opportunity to view the home and meet face-to-face with the owners.

- **Geographic farm area.** Successful farming requires a long-term commitment. Think in terms of years, not months. Before you select an area to farm, you need to do your homework. Things to consider include the number of homes in the area, price ranges, turnover rates, increasing price values, and whether or not it is currently being farmed by several real estate companies. The area must yield sufficient transactions in a price range that will allow you not only to make a living but also to generate enough income to be able to fund your farming effort. Experts recommend an area of no more than 200 homes to start, but you can increase your farm as your business grows.

  Ideally, the area or areas would be close to where you work or where you live. The more convenient for you the better since you will spend a lot of time there. Convenience will also allow you to provide better service for your sellers.
Use the MLS to search for sold properties within the last year. Look at the
sold properties to determine the price range, the volume of sales, and the
brokerage firms that had the listings. If the same brokerage code is preeminent,
that means someone in that office is farming that area. If no one code appears
predominantly and there are numerous brokers with a few sales here and there,
then it is likely that no one is farming that area. Note, however, that just because
someone else is currently farming an area doesn't mean that you can't go there.
That's a business decision you'll have to make based on other real estate
companies' market saturation and strength.

You can determine how many homes are in a subdivision by using the MLS
Tax Search feature, by going to the county Property Appraiser website, or by
using the tax roll feature at Floridarealtor.org. You want to determine how many
homes have sold within the last year in relationship to the number of homes in
the subdivision. A turnover ratio between 10% and 15% would be good; anything
less and it may not be worth your effort and expense and may take a
considerable amount of time to get established.

Example:

You find out in your search that 93 homes have sold in the last year in a
subdivision of 700 homes. Take the number of sold homes and divide it by
the number of homes in the subdivision. This will give you the turnover rate.
(93 ÷ 700 = 13% turnover)

Establish yourself in your farm area by direct mail, phone calls, e-mails, or an
area newsletter. A combination of all methods would virtually ensure a quick
success in becoming known in your farm area.

Again, consistency is important. Contact your farm area at least twice in the
first month, after that a minimum of once a month and at the same time of the
month. In addition, be consistent in your message. Decide what you want your
message to be and carry it through all of your marketing materials.

- Past clients. As mentioned earlier, this business comes from work you have
already done. Since you have an established working relationship with these
clients, they are inclined to work with you again or refer you to their friends and
relatives. The key here is to keep in contact with them on a regular basis. Past
clients should hear from you at least twice a year. Send them a holiday card,
New Year's card, letter, anything with your name, picture, and phone number on
it. Some licensees send out monthly mailers to their past clients. There are even
companies that will perform that service for you. If you don't maintain some level
of regular contact, these clients will tend to forget about you in a relatively short
period-of-time.

Prospecting through Marketing

Real estate has changed drastically over the past ten years. For today's real estate
professional, our business is now becoming advice based, not product based. Due to the
growth in popularity and availability of the Internet, consumers no longer need real
estate professionals to find information about a property or market conditions. Today, the
consumer has access to county tax rolls, public records, subdivision plat maps, aerial
views, and market statistics. That's just some of the information that is readily available.
It is imperative that you position yourself as an informational resource to the consumer. You need to become a trusted real estate adviser. For you, there are two types of marketing and, and it would be beneficial for you to understand the difference between the two.

- **Push marketing.** *Push marketing* is the traditional form of marketing that is used by real estate professionals. Push marketing is defined as using various activities to get your message in front of your ideal client. The marketer is in control of what the message is, and how, when, and where it is seen. It still has its place for sure, but you can no longer rely on it as your sole marketing method. If that's the only method you use, you run the risk of missing a large portion of the buyers and sellers in your target market.

  Push marketing includes:

  - Mail-outs
  - Flyers
  - Newspaper ads
  - Magazine ads
  - Radio
  - TV
  - Cold calling

  Studies show that consumers are bombarded by over 5,000 marketing ads per day. Your ads are just one of many.

- **Pull marketing.** *Pull marketing* is about developing relationships that attract your ideal client to you. It is social media in all its forms. In essence, the consumer comes to you. Of course, you don’t want to wait for the consumer to stumble upon you. It’s better for you to go out, find them, and bring them back.

  The simple fact is that before long “generation Y” (your future customer) will outnumber baby boomers and be the largest segment of the population. Over 96% of your future customers are current members of and use social media sites.

  Consider using social media sites like Facebook, Twitter, and LinkedIn as part of your pull marketing strategy. If you like spending time on the Internet and are good at writing and posting helpful tips, consider starting a real estate blog and use Google Analytics to track your results. As with all other forms of prospecting, you must be consistent or your results will suffer.

**Tombstone Advertising vs. Direct Response**

*Tombstone advertising* is any type of advertising that is put in front of consumers whose results cannot be measured. Examples may include:

- Bus bench advertising
- Billboards
- Stadium advertising
- Radio advertising (to some degree)
**Direct response advertising** is any type of advertising that can be measured by the direct response of a consumer.

An example includes:

- A Google pay-per-click campaign can be measured by the number of clicks.

Tombstone advertising can be turned into direct response advertising by including tracking mechanisms.

Tracking mechanisms examples include:

- A tracking phone number included in a newspaper ad.
- A personalized URL or campaign-specific landing page included in a direct mail campaign.

**Using Color in Prospecting and Marketing**

Color is an important detail that deserves your full attention when designing your prospecting materials. Color can have a dramatic effect on your prospects; it can influence their mood or their opinion of you before they even read the prospecting piece. The message you want to convey to your prospect will be enhanced by the color you use, so decide what your message will be and then choose the appropriate colors.

Consider these options:

- **RED** is a true attention getter. When you use red in your marketing pieces, it will grab the reader’s attention and their eyes will tend to look there first. Use red to capture attention and get the prospects to take action. Red is a very aggressive color.

- **BLUE** conveys an upscale image, an image of trust, experience, and credibility. Blues tend to be very effective with older prospects.

- **YELLOW** is the color for happiness and a feeling of well-being. Yellow is very lighthearted and welcoming and exudes energy. This applies to the various shades of yellow and gold.

- **GREEN** is the opposite of red. It is neither threatening nor aggressive. Green denotes that something is good for us and it ignites feelings of nature.

**Prospecting Tips for Success**

Remember that prospecting is the lifeblood of the real estate business and it never stops. Your real estate business is built upon the prospecting you do and how effectively you do it.

- **Make time every day for prospecting.** Take at least an hour or two a day to contact new prospects.

- **The prospecting never stops.** Tough times never last, but tough prospectors do. The more you prospect, the more successful you will be.
- **It's all about the numbers.** The more people you talk to, the more successful you will be. It's just that simple.

- **Be consistent in your message.** Do this with all of your prospecting. Whether you are cold calling, sending e-mails or direct mail, or knocking on doors, the message you convey must be consistent and to the point.

- **Network, network, network.** Try to use every social event as a networking opportunity. Look at meetings, parties, soccer games, or Little League as networking opportunities. Never go to lunch alone; always invite a potential prospect. Networking expands your potential prospects exponentially.

- **Don't take it personally.** No one likes rejection. However, just remember: It's not personal; it's business. Rejection is a very small part of prospecting.

- **Never give up.** Anyone can prospect for a week or two, but the true professional never stops prospecting. The next big prospect is just around the corner and if you quit now, you'll never have the opportunity to make their acquaintance.

- **It's okay to say no.** If the seller or buyer is not motivated, it's okay to say no. Your time is valuable and if a prospect is not motivated, it's a waste of your time, energy, and money.

## The Listing Presentation

All of your prospecting and networking will mean nothing if you get the appointment but then don't get the listing. When you are face-to-face with the seller, you have to explain to them why it is to their benefit to hire you. You only have one chance to do it and you have to do it in a relatively short period-of-time. So, be prepared and know what you're doing.

The true key to success in the listing presentation is practice, practice, practice. After you have built the listing presentation manual (discussed below), practice it until you know it like the back of your hand. You should know exactly what you are going to say before you ever arrive at the appointment.

## Things to Bring to the Listing Presentation

You should bring the following items to the listing presentation appointment.

- The listing presentation manual (See “The Listing Presentation Manual” below.)
- All support material for the listing presentation, newspaper articles, magazine articles, Internet articles, market statistics and facts
- Examples of all of your marketing materials
- The CMA (if you have prepared one)
- Two listing agreements completed with the seller’s information, except for the price
- Sellers Property Disclosure Statement
- Digital camera
- Laser rangefinder or tape measure to take measurements
- Calculator
- Flashlight
Start accumulating these items today. Make a copy of any articles that you see that are relevant for use in your presentation. Keep any market statistics or data in support of your presentation. Be sure to keep an eye out for marketing studies, particularly those that cite Internet statistics. These can be valuable in your marketing presentation.

**THE LISTING PRESENTATION MANUAL**

It is extremely important to build a good listing presentation. Creating a good presentation involves considerable time and effort over several weeks. Your presentation is a work-in-progress. As you become more experienced and proficient, your presentation evolves with you.

The importance of a professionally prepared listing presentation cannot be overstated. It’s a mistake to think you can go to the appointment, sit face-to-face with a seller, and wing it. All of your prospecting, cold calling, and canvassing will be worthless if you cannot close the deal and get the seller’s listing. The more prepared you are, the more professional you will appear, and the more likely you will be hired.

Concentrate on highlighting the things that make you different from the hundreds of other real estate professionals from whom a seller can choose. Keep that in mind as you start to build your listing presentation. Your presentation emphasizes who you are, how you work, and how you market the seller’s property, but never lose sight of the fact that it’s really about the seller. Everything in your presentation must show the seller how you plan to reach their ultimate goal, which is to sell their home. You must be able to explain to them how each item in your presentation benefits them.

Your listing presentation manual contents are outlined below.

**Front Cover**

The front cover should display a picture of the seller’s property with the seller’s name and address, and your contact information. You can find photos and much more information on most county appraisal websites that will assist you in creating the front cover.

**Cover Letter**

The cover letter should outline the information that you are giving to the seller and how plan to work for them to sell their home.

**Professional Resume**

Your professional resume should list your professional qualifications.

**Professional Affiliations**

Your list of professional affiliations should include the professional organizations of which you are a member. (You can combine this with your professional resume.)

**Company Profile**

Your company profile should give information about your company.
Personal Profile

A good personal profile should include your experience, education, professional affiliations, and community involvement. You can also add information about your background, family, and hobbies, but this is optional. Keep your personal profile up-to-date. As your business grows, so will your experience, education, and affiliations.

Comparative Market Analysis (CMA)

It’s always wise to arrive at the listing appointment with a good idea of the market value of the home you are visiting. However, in many cases your first appointment with the seller is also the first time you are touring the home. If this is the case, performing a complete CMA before the appointment may prove to be difficult. This brings up a question as to the value of a one-step listing appointment versus a two-step appointment.

1. One-step listing appointment. With easy access to just about everything on the computer, you might be able to perform a CMA strictly from online records. The problem is that although the values in each neighborhood fall within a certain price range. When you are setting up an appointment for a listing presentation, one of the first questions you should ask the seller is, “How much are you expecting to get from the sale of your property?” Once you have that information, you can prepare a CMA that supports the market value, and hopefully, the seller’s expectations.

Even with the best intentions, using this approach to prepare a CMA may not make allowances (either negative or positive) for an individual property. The property may have features that can’t be ascertained from public records, such as outdated appliances, window air conditioning units, damaged floors or roof, or an overall general poor condition. On the other hand, if the seller has updated the bathrooms, installed new kitchen appliances, or freshly painted the entire home, you would have no way to take that into consideration either.

2. Two-step listing appointment. A two-step listing appointment allows for some reflection and comparison on your part. With the two-step approach, you can make a pre-listing appointment with your seller in which you tour the property for ten to fifteen minutes while taking notes. After the tour, you can perform the CMA, develop a suggested asking price, and provide that information to the seller at the second appointment.

Although the two-step listing approach seems to be the preferable approach, it’s not always possible to make it happen. Sometimes, the seller expects to list their property directly after the first appointment. You may be in a position either to take the listing immediately or risk losing it. When this happens, you should use your best judgment and knowledge of the local market when counseling the seller on the asking price. Then, immediately following the appointment, perform a complete CMA as backup if the listing price turns out to be too high and a price reduction is in order.

Marketing Plan

A custom-designed marketing plan is the most important part of the listing presentation. The marketing plan shows the seller how you are going to advertise, market, and sell their home. Be creative and utilize all of the tools at your disposal to build your marketing plan. (See The Advertising Plan later in this chapter for more detail.)
If there are other services that you can provide, include them in your marketing plan.

**Example Marketing Statements:**

Specifically, I will market your property through:

- Community and school reports to all buyer prospects
- Company Web site
- Direct email notices
- Direct mail and email campaigns
- For sale sign
- Home highlight sheets to all agents in my company’s local offices
- Local real estate paper
- Multiple listing service (MLS)
- My Web site
- Notification to all potential buyers in my database
- Notification to the area’s top 50 real estate licensees
- Open houses
- Real estate broker tours
- www.REALTOR.com

I will also provide you with these additional services:

- Help you determine the best asking price.
- Offer proven advice on how to prepare your property for showings.
- Call you regularly, and provide you with a Customer Service Web Page so you stay fully informed of everything I do to sell your home.
- Provide feedback from all showings and open houses.
- Update you on money market changes that could affect your property’s sale.
- Pre-qualify potential buyers.
- Present and discuss each offer with you and provide a “cash in pocket” statement.
- Negotiate the highest possible price and best terms for you.
- Manage all contractual, title, and transaction details and keep you informed.
- Ensure your check is delivered at closing.
- Arrange for a moving company and relocation agent, if required.

**Brokerage Comparison Chart**

A brokerage comparison chart should show how your services compare to that of other brokerage offices.

**Client Testimonials**

Client testimonials can be an excellent source of credibility. The testimonials must be real and from your past or present clients. If you feel you’ve done an excellent job for a client, ask them for a written testimonial. Most clients are happy to oblige.

Bob Broker is a relationship-driven professional who has a high attention to detail and works diligently to ensure a positive outcome for his clients. He sold our house in four weeks! Thanks, Bob!
**Note:** The Federal Trade Commission (FTC) investigates claims of false or misleading testimonials. If found guilty, the penalties can be severe.

**Support Materials**

Support materials include everything else you need to complete the listing presentation. These materials consist of any newspaper articles, magazine articles, and statistical information that support your listing presentation. Make sure this information is organized and easily available when needed.

**TIPS!** You might be able to use presentation materials that are provided by your company or broker. The MLS has professionally prepared presentation templates for your use; all you have to do is customize them.

**Home Preparation and Staging Tips**

A document with tips on how to prepare their home for sale should list general suggestions to your seller about possible repairs or maintenance needed before placing their home on the market. (See below.)

Home preparation and staging tips can be extremely helpful to sellers; especially those who have owned their homes for some time and are unaware of how to make their home appealing to a broad range of potential buyers.

Buyers start forming an opinion about a home in as little as two seconds from walking through the front door; they solidify that opinion within the next 20 seconds. For this reason, first impressions are crucial. Buyers begin judging a home the moment they see it. Buyers look for homes that are in move-in condition and free of clutter; homes they can actually visualize themselves living in. We call it *emotional possession.* These tried and true tips are extremely cost-effective, and can produce substantial results. Make sure you convey this message to your sellers. Let them know you are familiar with the way buyers react, what they see as negatives and positives in their home and discuss it with them. That way when potential buyers preview their home they won’t be surprised or disappointed when these types of comments are made.

A document with tips on how to stage the home for showing should give suggestions to the seller regarding how to stage the home in order to appeal to the largest cross-section of buyers.

The combined preparation and staging tips are provided on the next page.
### Home Preparation Tips

#### Exterior

1. Mow and rake the lawn, trim hedges, remove weeds, and edge gardens.
2. Sweep sidewalks and driveway; pick up any litter.
3. Repair gutters and eaves; touch up exterior paint.
4. Plant extra flowers for color, or place potted plants beside the front door.
5. Clean or paint front door, polish front door hardware, ensure that the doorbell works.
6. Oil squeaky doors, inside and out.
7. Clean windows inside and out.

#### Interior

1. Clean and tidy up the entrance, clear stairs and halls, store all excess furniture.
2. Brighten interiors with fresh, light-colored paint.
3. Brighten rooms by installing high wattage light bulbs and turn them on.
4. Remove family pictures. Buyers want to take ownership while they tour a home. The presence of family pictures makes it more difficult for them to do this.
5. Remove accumulated clutter and unnecessary decorations.
7. Organize kitchen countertops to make them look more spacious. To do this, remove unnecessary appliances and clutter.
8. Clean kitchen countertops, cabinets, appliances, and dish washer.
9. Organize and clean out closets to make them look larger.
10. Clean and freshen up bathrooms, put out clean towels, and reduce clutter.
11. Remove any mold from the tile in the bathrooms.
12. Replace caulking and tile grout in bathrooms and kitchen.
13. Clean mirrors so they sparkle.
14. Organize and clean the garage.
15. Perform necessary minor repairs and touch-ups to walls, windows, fixtures, etc.

### Home Staging Tips

1. Do not be at home during the showing. Buyers feel more comfortable to make comments or ask questions when the seller is away.
2. Turn on the air conditioner or heat to achieve an interior temperature of 72°F.
3. Open the drapes or blinds and turn on all of the lights in every room.
4. Turn on the sound system to play quiet background music. Turn off the TV.
5. Keep pets outdoors or in a kennel during the showing.
6. Remove clutter from kitchen counters and tables.
7. Keep the front yard free of bicycles, toys, and other clutter.
Moving Preparation Checklist

Once you acquire the listing, the moving preparation checklist below titled “Before the Move” is a great asset to sellers.

<table>
<thead>
<tr>
<th>8 Weeks before the move:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Get estimates from three professional movers.</td>
</tr>
<tr>
<td>Contact the Chamber of Commerce of your new town to get their Residential Information Packet.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>6 Weeks before the move:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory everything; decide what to move, sell, replace, or donate.</td>
</tr>
<tr>
<td>Complete change of address forms at your local post office.</td>
</tr>
<tr>
<td>Obtain copies of all medical, dental, legal, and accounting records for your family, and veterinarian records for your pets, if applicable.</td>
</tr>
<tr>
<td>Review moving related costs, including packing, loading, special charges, and insurance.</td>
</tr>
</tbody>
</table>

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<thead>
<tr>
<th>4 Weeks before the move:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertise the sale of unneeded furniture, accessories, clothes, etc.</td>
</tr>
<tr>
<td>If moving yourself, secure boxes, packing material, tape, markers, etc.</td>
</tr>
<tr>
<td>Arrange for short- or long-term storage, if necessary.</td>
</tr>
<tr>
<td>Make travel arrangements for pets, if necessary.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2 Weeks before the move:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prepare your car for the trip; check tires and make repairs, if necessary.</td>
</tr>
<tr>
<td>Cancel newspaper subscriptions and other delivery services.</td>
</tr>
<tr>
<td>Pack any items that you don’t need until after the move, or those items that will be put in storage.</td>
</tr>
<tr>
<td>Gather all packing materials and equipment.</td>
</tr>
</tbody>
</table>

<table>
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<tr>
<th>1 Week before the move:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organize important papers, records, and valuables for protected shipment or storage in a safe deposit box.</td>
</tr>
<tr>
<td>Notify friends and neighbors of your new address and contact information.</td>
</tr>
<tr>
<td>Fill any necessary prescriptions or medications that you’ll need for the next two weeks.</td>
</tr>
<tr>
<td>While packing, combine items that will go together in your new home.</td>
</tr>
</tbody>
</table>

Moving day:

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<tbody>
<tr>
<td>Get cash and certified checks to pay movers, etc.</td>
</tr>
<tr>
<td>Pack valuables, financial records, and personal papers to keep with you.</td>
</tr>
</tbody>
</table>

Have fun and enjoy your new home!
Making Your Presentation a Success

There are many ways in which to make your presentation a success. We will discuss some of those ways in the following pages.

Be on Time

One of the easiest things you can do to make your presentation a success, is to make good first impression. An important part of that is to be on time to the appointment.

If you are too early, you may interrupt the seller's schedule as they finish a meal or are trying to clean up. This may be very upsetting to them.

If you arrive late, the seller may think that you aren't interested in securing their business, are unorganized, or, worse yet, don't keep your word.

Remember, this appointment is all about them. If you are late, refrain from a long-winded explanation about why you are late. Stick to their topic of interest, which is all about their wants and desires.

Appropriate Dress

The way you dress speaks volumes about who you are as a person and as a real estate professional. You will not get a second chance to make a first impression. You don't have to say a word; people will think one thing if you're dressed in jeans, and another if you're dressed professionally. It doesn't matter who you are, your clothes will speak for you.

Some of the perceptions people may form solely from your appearance are your:

- Professionalism
- Intelligence
- Credibility
- Income
- Sophistication

These perceptions, whether real or imagined, accentuate how your appearance instantly influences the opinions of all those with whom you come into contact. Being well dressed in a business setting can influence not just perceptions, but also your success.

Keys to a Successful Listing Presentation

There are five key steps to a listing presentation. Each is critical to your success in the listing process.

Step 1  Take Control

It is imperative for you to take control of the entire listing appointment. This starts when you approach the front door. Take one-step back from the door to ensure that you don't invade the homeowner's space when he or she opens the door.

Take detailed notes of the home's features. While viewing the home, it is critical that you start to build rapport with the seller by casual conversation. Ask relevant questions to gather information about their needs, their timeframe, the price they
may have in mind, and their level of motivation. Be sure to view the entire home, including the garage and exterior.

Once the tour is complete, ask if you can sit in the kitchen to talk. The kitchen is usually reserved for friends and family, and you want to be thought of that way. Sitting in the kitchen will go a long way toward reaching that goal. If the kitchen does not have an eat-in area, the dining room will work. However, never sit in the living room.

The living room is formal and reserved for guests; you do not want to be thought of as a guest. You’ll give up total control of the listing presentation if you are sitting in the living room. Always try to sit in the kitchen, if available.

If there is more than one seller, be sure to sit so that you can see and talk to all of them at the same time. One way to accomplish this is for you to sit on one side of the table and the sellers on the other. It is imperative to make eye contact with all of your sellers at the same time without having to look back and forth.

**Step 2** Qualify the Seller

If you asked the right questions during the home tour, you should have a good idea of the seller’s level of motivation. By now, you should know if they are motivated to sell and if they are realistic regarding the price and amount of time it may take to sell their home. If you haven’t been able to get a clear picture by this point, you need to ask more questions. Be careful not to just promote all the wonderful programs your company offers but, take the time to interview your seller, thereby gaining valuable information.

If you are dealing with a seller, whose home did not sell the first time they listed it (expired listing), start by asking why they feel their home did not sell. In many cases, the seller may feel it was the previous broker’s fault. Be sure to ask the proper questions to ascertain exactly what the previous broker did or did not do. This approach will provide insight into what the seller feels is important and you can stress those things when you talk about your services.

A carefully planned seller interview will help you understand the seller’s motivation and expectations. Suggested questions to use in the interview include:

- When did you first start thinking about selling your home?
- Why are you moving?
- How long have you lived in this home?
- What was your original purchase price?
- What made you want to buy this house?
- What improvements have you made to your home?
- If you could change anything about your home, what would it be?
- What distinguishing features do you like about your neighborhood?
- Are there any negatives to this neighborhood? (Such as HOA, traffic, etc.)
- How did you arrive at your asking price?
- Where are you planning to move?
- When would you like to be in your new home?
- In listing your property, what is most important to you? Price, timing, or convenience?
- What would happen to your plans if you did not sell?
- Whom else have you been talking to about the sale of your home?
- Do you have to sell your present home to buy a new one?
- How do you feel about owner financing?
- What is the approximate balance on your present mortgage?
- What would it take to get your home listed with me today?
If you find that the sellers are not realistic about price or do not appear to be motivated about the sale of their home, it may not be worth your time, effort, and money to take the listing. That’s a decision you will have to make.

Step 3  Sell Yourself

You are now face-to-face with the seller and have their complete attention. Now is your chance to tell the seller what makes you different from other agents. Make sure that they know your “point of difference.”

To do this, following the steps below to make your listing presentation.

- Lay out the presentation manual on the table in front of you, facing the home seller. Do not hand it to them. Tell the seller that you’d like to start by telling them a little bit about who you are, how you work, and exactly what you can do for them. Tell them that after that you’ll talk about where you feel they stand in the marketplace.

- Open the presentation manual to the page about your credentials and explain it briefly. When talking to the seller, keep the emphasis on them by saying something like, “Would it be important to you to work with someone who has the highest professional designations in the industry? Well, as you can see, I have the following designation and this is what it means to you.”

  Do the same with your professional affiliations, using the same phrases, “Would it be important to you…?”

  Then talk about your company. Explain what makes your company special and why that is important to the seller.

- Next, talk about your marketing plan. If you present this plan properly, the sellers will be more than ready to hire you, even before you bring up the subject of their home’s value. It is critical that you present your marketing plan in a fashion that separates you from the thousands of other realtors. Make sure at all times to explain why it is critical to the seller that they have your services.

  You may encounter some objections or questions about your marketing plan from the seller at this point. If the seller raises some objections, deal with them when raised. Most objections come up after you discuss the CMA and price.

Step 4  Discuss the Listing Price

Discuss the CMA next, if you prepared one. Be as detailed or as brief as the seller wants to be with this section of your presentation. Explain the market conditions that exist in their area or building. After presenting your CMA, but before giving them your opinion of value, ask them what price they had in mind.

- If their price is in line with yours, that’s great.
- If their price is substantially higher than yours, ask them how they arrived at that number.
- If they won’t tell you what price they had in mind or if their price is substantially different, you will have to reveal your price opinion and overcome their objections, if any.

If the seller is not realistic about the value of their home and you are not able to overcome their objections, you may want to consider declining the listing.
Step 5  Close the Listing

Once you and the seller have discussed the price, it’s time to ask for the listing. Pull out your listing agreement form, ask for the listing, and wait for a response. Ask them what price they have decided upon, fill in the blank where it says price, and then go over the agreement with them. Cover all the important features, including the price, the term of the listing, and the commission. Make sure the sellers sign and initial everywhere required. You also want to make sure that the seller fills out the Sellers Property Disclosure at the time of listing.

While the sellers are signing the agreement and filling out the property disclosure statement, ask permission to take pictures of the property. Make sure you take pictures of both inside and outside.

Things to Tell the Seller at Time of Listing

Once your seller has agreed to give you the listing, you must provide them with an Agency Relationship Disclosure Notice, unless you are acting as a transaction broker. The following is additional information you should tell your seller at the time of listing.

- How you will communicate with them. Be sure to get all of their contact information, including home phone, cell phones, work numbers, and e-mail address.
- How they can communicate with you.
- How you will handle showing appointments. Be realistic about the number of showings once the property is on the market.
- Tips for staging the home for showings (in your listing presentation).
- Why it’s important for them not to be home during showings.
- The use of a lockbox.
- How you will handle any offers to purchase on their home.

You don’t need to obtain all of this information at the listing appointment. However, you should get the information from the seller as soon as possible so that you will be prepared once a contract comes in.

- The seller’s Social Security number
- A copy of their prior title policy
- Contact information for the homeowner association, condo association, or management company
- Mortgage information, including loan number and contact information
- Seller Property Disclosure Statement
LISTING CONTRACTS

A listing contract is an employment agreement between your broker and a property owner, which establishes the agreed-upon terms, such as asking price, term of the listing, obligations of the owner, and obligations of the broker under the contract. The listing contract must also state the amount of commission the owner will pay and the condition of employment for earning the commission.

In Florida, a listing agreement may be oral, written, or implied. However, you are best protected by a written listing contract.

If the listing contract is written, it must contain the following items:

- A definite termination date of the agreement
- The complete legal description of the property
- Price and terms offered
- A promise of compensation and the specifics of that compensation
- Signatures of all property owners and the broker or licensee

A listing contract cannot contain an automatic renewal clause. You must provide the owner with a complete copy of the agreement within 24 hours of signing.

Types of Listing Contracts

- **Open listing.** An open listing means that the owner agrees to pay a commission to any broker who provides a buyer willing to purchase the property under a price and terms agreeable to the owner. An open listing is a one-sided or unilateral contract. It is only binding upon the owner to pay the commission upon performance by the broker. The broker has no obligation to perform.
  
  An owner can give an open listing to any number of brokers.
  
  An open listing cannot be placed in the MLS.

- **Exclusive agency or exclusive listing.** An exclusive agency or exclusive listing means that the owner can list the property with only one broker. This type of listing is a bilateral contract. It is binding on both the broker and the owner. All other brokers are required to work through the listing broker.
  
  The owner agrees to pay the commission to the listing broker if the broker performs under the terms set forth in the listing contract.
  
  The owner reserves the right to sell the property himself or herself, in which case the owner will owe no commission to the listing broker.
  
  An exclusive listing may be placed in the MLS.

- **Exclusive right of sale listing.** An exclusive right of sale listing must be in writing and signed. This type of listing is a bilateral contract. The owner can list with only one broker and the owner agrees to pay the listing broker regardless of who actually finds the buyer.
  
  The owner will owe the commission even if he or she procures the buyer or the property sells through another broker during the term of the listing.
  
  Without a doubt, a broker is best protected by this type of listing agreement.
  
  An exclusive right of sale listing may be placed in the MLS.
• **Net listing.** A *net listing* is not, technically, a type of listing agreement. You could structure any of the three types of listing contracts above as a net listing. In a net listing, an owner sets a minimum amount that he wants to receive from the sale of the property. The broker’s commission is any amount above the set minimum, provided that amount does not exceed the commission amount agreed upon in the listing contract.

**Example:**

Patrick, the seller, tells Alice, the broker, that he wants $225,000 from the sale of his home. Alice sells the home for $275,000, so Alice receives a $50,000 commission. If however, the maximum commission amount allowed according to the listing contract is $30,000, Alice must give the excess of $20,000 from the sale to Patrick. She cannot make more than the agreed-upon $30,000 commission.

Net listings are illegal in many states because they give unscrupulous brokers an opportunity to take advantage of a seller who may not know what his or her property is truly worth. However, net listings are legal in Florida, although they are generally discouraged. Although the seller gets what he or she wants for the sale, it creates a conflict of interest for the broker. It essentially violates the broker’s responsibility of putting the client’s interests above his or her own.

**Preparing Contracts**

Real estate brokers or their affiliated licensees can prepare real estate contracts, listing agreements, basic option contracts, and buyer broker agreements. Brokers may prepare only a lease that is approved by the Florida Supreme Court. Using the prepared lease form, licensee may only fill in the blanks and may not delete anything from or add anything to the lease. The lease cannot be for a period of more than one year.

A broker cannot prepare contracts for deed, mortgages, deeds, assignments or assumptions or leases other than ones approved by the Florida Supreme Court. Licensees should refer their clients to an attorney for preparation of any complicated option contracts or purchase and sales contracts.

**Example:** Preparing an Exclusive Right of Sale Listing Agreement

It is extremely important that you fill out the listing agreement completely and correctly at the time of listing. This will ensure that the seller complies with your agreement and you receive compensation for your efforts. In the following pages, we provide you with instructions on how to complete the Exclusive Right of Sale Listing Agreement (Form ERS-17tb Rev 6/17) as approved by the Florida Association of REALTORS®. (For the complete form, see the Forms section of this book.) (This was the current form at the time this book was printed.)

When talking with the seller it is always preferable to refer to the listing contract as an agreement, as in “would you mind signing our agreement.”

When filling out a listing agreement, never leave a space blank. If something does not apply, enter either a zero or N/A.
How to Complete the Exclusive Right of Sale Listing Agreement

Page 1

Exclusive Right of Sale Listing Agreement

1. This Exclusive Right of Sale Listing Agreement ("Agreement") is between
   ____________________________ ("Seller")
   and ____________________________ ("Broker").

2. Authority to Sell Property: Seller gives Broker the EXCLUSIVE RIGHT TO SELL the real and personal property
   (collectively "Property") described below, at the price and terms described below, beginning
   _______ and terminating at 11:59 p.m. on _______ ("Termination Date"). Upon
   full execution of a contract for sale and purchase of the Property, all rights and obligations of this Agreement will
   automatically extend through the date of the actual closing of the sales contract, Seller and Broker acknowledge
   that this Agreement does not guarantee a sale. This Property will be offered to any person without regard to race,
   color, religion, sex, handicap, familial status, national origin, or any other factor protected by federal, state, or local
   law. Seller certifies and represents that she/he/it is legally entitled to convey the Property and all improvements.

3. Description of Property:

   a. Street Address: ____________________________

   b. Personal Property, including appliances:

   c. Occupancy:  
      Property □ is □ is not currently occupied by a tenant. If occupied, the lease term expires ____________

   Line 2: Write in the complete name of the seller(s). If only one name shows on the
   tax roll as the owner, but you are certain they are married, always add the
   name of the spouse who does not appear on the tax roll. You may not be
   able to sell the property without the spouse’s permission.

   Line 3: Write in the complete name of your brokerage company.

   Line 4: 1. Authority to Sell Property:

   Lines 5 - 6: Enter the beginning and ending dates of the agreement, which is usually a
   180-day period to start.

   Line 12: 2. Description of Property:

   Line 13: (a) Street Address: Write in the complete street address of the property.

   Lines 15 - 16: Legal Description: Enter the complete legal description of the property. If
   you need more space for the legal description, check the “See Attachment”
   box and include the legal description on an addendum.

   Lines 17 - 18: (b) Personal Property, including appliances: List all of the personal
   property (including appliances) that is included in the sale. For example:
   window treatments as placed, carpeting as placed, fixtures as placed, pool
   equipment as placed, hot tub or spa, and so on. If you need more space,
   check the “See Attachment” box and include a separate addendum.

   Line 20: (c) Occupancy: Check the applicable box. If occupied, enter the lease
   expiration date.
Chapter 4

Page 1 (cont’d.)

3. Price and Terms: The property is offered for sale on the following terms or on other terms acceptable to Seller:

(a) Price: $______

(b) Financing Terms: ☐ Cash ☐ Conventional ☐ VA ☐ FHA ☐ Other (specify) ☐ Seller Financing: Seller will hold a purchase money mortgage in the amount of $______ with the following terms:
☐ Assumption of Existing Mortgage: Buyer may assume existing mortgage for $______ plus an assumption fee of $______, the mortgage is for a term of ______ years beginning in ______ at an interest rate of _____% ☐ fixed ☐ variable (describe) ________
☐ Lender approval of assumption ☐ is required ☐ is not required ☐ unknown. Notices to Seller: (1) You may remain liable for an assumed mortgage for a number of years after the Property is sold. Check with your lender to determine the extent of your liability, Seller will ensure that all mortgage payments and required escrow deposits are current at the time of closing and will convey the escrow deposit to the buyer at closing.
(2) Extensive regulations affect Seller financed transactions. It is beyond the scope of a real estate licensee’s authority to determine whether the terms of your Seller financing agreement comply with all applicable laws or whether you must be registered and/or licensed as a loan originator before offering Seller financing. You are advised to consult with a legal or mortgage professional to make this determination.

(c) Seller Expenses: Seller will pay mortgage discount or other closing costs not to exceed _____% of the purchase price and any other expenses Seller agrees to pay in connection with a transaction.

Line 21: 3. Price and Terms:

Line 22: (a) Price: Enter the agreed-upon asking price when you know it.

Line 23: (b) Financing Terms: Check the applicable financing term boxes. If other, write in what that means.

Lines 24 - 25: Seller Financing: Check the box and fill in the blanks if the seller will hold a purchase money mortgage.

Lines 26 - 28: Assumption of Existing Mortgage: Check the box on line 26 if the seller’s mortgage is assumable and enter the amount of that mortgage. Indicate any assumption fee on line 27, along with the term of the mortgage and the year it began. On line 28, enter the interest rate of the assumed mortgage and check the box as to whether it is fixed or variable.

Line 29: Check the appropriate box regarding lender approval assumption.

Line 37: (c) Seller Expenses: If the seller agrees to pay mortgage discount points or other closing costs, enter the percentage number.

4. Broker Obligations: Broker agrees to make diligent and continued efforts to sell the Property until a sales contract is pending on the Property.

5. Multiple Listing Service: Placing the Property in a multiple listing service (the ‘MLS’) is beneficial to Seller because the Property will be exposed to a large number of potential buyers. As a MLS participant, Broker is obligated to timely deliver this listing to the MLS. This listing will be promptly published in the MLS unless Seller directs Broker otherwise in writing. Seller authorizes Broker to report to the MLS this listing information and price, terms, and financing information on any resulting sale for use by authorized Board / Association members and MLS participants and subscribers unless Seller directs Broker otherwise in writing.

Line 39: 4. Broker Obligations:

Line 41: 5. Multiple Listing Service:

Note: Seller and broker should initial the bottom of each page in the spaces provided.
6. Broker Authority: Seller authorizes Broker to:

(a) Advertise the Property as Broker deems advisable including advertising the Property on the Internet unless limited in (b)(a)(i) or (b)(a)(ii) below.

(Seller opt-out) (Check one if applicable)

(i) □ Display the Property on the Internet except the street address.

(ii) □ Seller does not authorize Broker to display the Property on the Internet. Seller understands and acknowledges that if Seller selects option (ii), consumers who search for listings on the Internet will not see information about the Property in response to their search.

(b) Place appropriate transaction signs on the Property, including “For Sale” signs and “Sold” signs (once Seller signs a sales contract) and use Seller’s name in connection with marketing or advertising the Property.

(c) Obtain information relating to the present mortgage(s) on the Property.

(d) Provide objective comparative market analysis information to potential buyers.

(e) (Check if applicable) □ Use a lock box system to show and access the Property. A lock box does not ensure the Property’s security. Seller is advised to secure or remove valuables. Seller agrees that the lock box is for Seller’s benefit and releases Broker, persons working through Broker, and Broker’s local Realtor Board / Association from all liability and responsibility in connection with any damage or loss that occurs.

(f) □ Withhold verbal offers. □ Withhold all offers once Seller accepts a sales contract for the Property.

(g) Virtual Office Websites: Some real estate brokerages offer real estate brokerage services online. These websites are referred to as Virtual Office Websites (“VOWs”). An automated estimate of market value or reviews and comments about a property may be displayed in conjunction with a property on some VOWs. Anyone who registers on a VOW may gain access to such automated valuations or comments and reviews about any property displayed on a VOW. Unless limited below, a VOW may display automated valuations or comments and reviews about this Property.

□ Seller does not authorize an automated estimate of the market value of the listing (or a hyperlink to such estimate) to be displayed in immediate conjunction with the listing of this Property.

□ Seller does not authorize third parties to write comments or reviews about the listing of the Property (or display a hyperlink to such comments or reviews) in immediate conjunction with the listing of this Property.

Line 47: 6. Broker Authority:

Line 48: (a) Advertise the Property ...

Line 51: (i) Check this box if the seller wants the property displayed on the internet.

Line 52: (ii) Check this box if the seller does not want the property displayed on the internet.

Line 55: Seller initials here if they checked the box on line 52.

Line 60: (e) Check the box on this line if the seller agrees to use a lock box system to show the property.

Line 64: Check either or both of the boxes, if needed, that say “Withhold verbal offers” or “Withhold all offers once Seller accepts a sales contract for the Property.”

Line 72: Check this box if the seller does not authorize an automated estimate of market value.

Line 74: Check this box if the seller does not authorize third parties to write comments or reviews about the listing.
7. Seller Obligations: In consideration of Broker's obligations, Seller agrees to:

(a) Cooperate with Broker in carrying out the purpose of this Agreement, including referring immediately to Broker all inquiries regarding the Property's transfer, whether by purchase or any other means of transfer, and (b) Provide Broker with keys to the Property and make the Property available for Broker to show during reasonable times.

c) Inform Broker before leasing, mortgaging, or otherwise encumbering the Property.

d) Indemnify Broker and hold Broker harmless from losses, damages, costs, and expenses of any nature, including attorney's fees, and from liability to any person, that Broker incurs because of (1) Seller's negligence, representations, misrepresentations, actions, or inactions; (2) the use of a lock box; (3) the existence of undisclosed material facts about the Property; or (4) a court or arbitration decision that a broker was not compensated in connection with a transaction is entitled to compensation from Broker. This clause will survive Broker's performance and the transfer of title.

e) Perform any act reasonably necessary to comply with FIRPTA (Section 1445 of the Internal Revenue Code).

(f) Make all legally required disclosures, including all facts that materially affect the Property's value and are not readily observable or known by the buyer, Seller certifies and represents that Seller knows of no such material facts (local government building code violations, unobservable defects, etc.) other than the following:

Seller will immediately inform Broker of any material facts that arise after signing this Agreement.

(g) Consult appropriate professionals for related legal, tax, property condition, environmental, foreign reporting requirements, and other specialized advice.

Line 76:

7. Seller Obligations:

Lines 89 - 92: (f) If the seller makes any material-facts disclosures, write them in here. You should also be using the Seller's Property Disclosure Statement.

Line 96:

8. Compensation: Seller will compensate Broker as specified below for procuring a buyer who is ready, willing, and able to purchase the Property or any interest in the Property on the terms of this Agreement or on any other terms acceptable to Seller. Seller will pay Broker as follows (plus applicable sales tax):

(a) 5.5% of the total purchase price plus $________ OR $________ no later than the date of closing specified in the sales contract. However, closing is not a prerequisite for Broker's fee being earned.

(b) __________ ($ or %) of the consideration paid for an option, at the time an option is created. If the option is exercised, Seller will pay Broker the Paragraph 8(a) fee, less the amount Broker received under this subparagraph.

Line 99: (a) Enter the percentage of the commission, or, if it is a fixed dollar amount, write in the amount.

Line 102: (b) If the seller is willing to enter into an option agreement, enter the percentage or dollar amount of the option money you will receive at the time the option is created. Discuss this amount with your broker.

Page 3

8. Compensation (cont'd.)

Line 105: (c) If the seller is willing to enter into a lease, enter the percentage of the lease value or the dollar amount you will receive if the seller enters into the lease agreement.
8. Compensation (cont'd.)

Line 112: (d) (3) Enter in the number of days that you would be protected after the listing expires for buyers to whom you introduced the property. This period of time is solely at your discretion. Time periods of 90 to 180 days are typical.

Line 117: (e) Enter a percentage of the deposits you would be entitled to receive if the seller retains the escrow deposit as liquidated damages.

9. Cooperation with and Compensation to Other Brokers: Notice to Seller: The buyer's broker, even if compensated by Seller or Broker, may represent the interests of the buyer. Broker's office policy is to cooperate with all other brokers except when (in Seller's best interest and to offer compensation in the amount of

Line 119: (3)

Enter the number of days that you would be protected after the 3 listing expires for buyers to whom you introduced the property. This period of time is solely at your discretion. Time periods of 90 to 180 days are typical.

Line 120: (e) Enter a percentage of the deposits you would be entitled to receive if the seller retains the escrow deposit as liquidated damages.

9. Cooperation with and Compensation to Other Brokers: Notice to Seller: The buyer's broker, even if compensated by Seller or Broker, may represent the interests of the buyer. Broker's office policy is to cooperate with all other brokers except when (in Seller's best interest and to offer compensation in the amount of

Line 123 - 126: Check the box that applies to the brokerage relationship of the buyer's broker as either a single agent, transaction broker, or no brokerage relationship with the buyer. Enter the percentage of the total commission or fixed dollar amount for that brokerage relationship. If none of the relationships apply, check "None of the above." If you check this box, you cannot put the property in the MLS.

10. Brokerage Relationship: Florida law requires that real estate licensees disclose their relationship to both buyers and sellers. This paragraph of the listing agreement satisfies your disclosure requirement for the seller.

11. Conditional Termination: At Seller's request, Broker may agree to conditionally terminate this Agreement. If Broker agrees to conditional termination, Seller must sign a withdrawal agreement, reimburse Broker for all direct expenses incurred in marketing the Property, and pay a cancellation fee of $ plus applicable sales tax. Broker may void the conditional termination, and Seller will pay the fee stated in Paragraph B(a) less the cancellation fee if Seller transfers or contracts to transfer the Property or any interest in the Property during the time period from the date of conditional termination to Termination Date and Protection Period, if applicable.

12. Dispute Resolution: This Agreement will be construed under Florida law. All controversies, claims, and other matters in question between the parties arising out of or relating to this Agreement or the breach thereof will be settled by first attempting mediation under the rules of the American Arbitration Association or other mediator agreed upon by the parties. If litigation arises out of this Agreement, the prevailing party will be entitled to recover reasonable attorney's fees and costs, unless the parties agree that disputes will be settled by arbitration as follows:

Arbitration: By initiating in the space provided, Seller ( ), Sales Associate ( ), and Broker ( ) agree that disputes not resolved by mediation will be settled by neutral binding arbitration in the county in which the Property is located in accordance with the rules of the American Arbitration Association or other arbitrator agreed upon by the parties. Each party to any arbitration (or litigation to enforce the arbitration provision of this Agreement or an arbitration award) will pay its own fees, costs, and expenses, including attorney's fees, and will equally split the arbitrator's fees and administrative fees of arbitration.

13. Dispute Resolution: This Agreement will be construed under Florida law. All controversies, claims, and other matters in question between the parties arising out of or relating to this Agreement or the breach thereof will be settled by first attempting mediation under the rules of the American Arbitration Association or other mediator agreed upon by the parties. If litigation arises out of this Agreement, the prevailing party will be entitled to recover reasonable attorney's fees and costs, unless the parties agree that disputes will be settled by arbitration as follows:

Arbitration: By initiating in the space provided, Seller ( ), Sales Associate ( ), and Broker ( ) agree that disputes not resolved by mediation will be settled by neutral binding arbitration in the county in which the Property is located in accordance with the rules of the American Arbitration Association or other arbitrator agreed upon by the parties. Each party to any arbitration (or litigation to enforce the arbitration provision of this Agreement or an arbitration award) will pay its own fees, costs, and expenses, including attorney's fees, and will equally split the arbitrator's fees and administrative fees of arbitration.

14. Dispute Resolution: This Agreement will be construed under Florida law. All controversies, claims, and other matters in question between the parties arising out of or relating to this Agreement or the breach thereof will be settled by first attempting mediation under the rules of the American Arbitration Association or other mediator agreed upon by the parties. If litigation arises out of this Agreement, the prevailing party will be entitled to recover reasonable attorney's fees and costs, unless the parties agree that disputes will be settled by arbitration as follows:

Arbitration: By initiating in the space provided, Seller ( ), Sales Associate ( ), and Broker ( ) agree that disputes not resolved by mediation will be settled by neutral binding arbitration in the county in which the Property is located in accordance with the rules of the American Arbitration Association or other arbitrator agreed upon by the parties. Each party to any arbitration (or litigation to enforce the arbitration provision of this Agreement or an arbitration award) will pay its own fees, costs, and expenses, including attorney's fees, and will equally split the arbitrator's fees and administrative fees of arbitration.

15. Dispute Resolution: This Agreement will be construed under Florida law. All controversies, claims, and other matters in question between the parties arising out of or relating to this Agreement or the breach thereof will be settled by first attempting mediation under the rules of the American Arbitration Association or other mediator agreed upon by the parties. If litigation arises out of this Agreement, the prevailing party will be entitled to recover reasonable attorney's fees and costs, unless the parties agree that disputes will be settled by arbitration as follows:

Arbitration: By initiating in the space provided, Seller ( ), Sales Associate ( ), and Broker ( ) agree that disputes not resolved by mediation will be settled by neutral binding arbitration in the county in which the Property is located in accordance with the rules of the American Arbitration Association or other arbitrator agreed upon by the parties. Each party to any arbitration (or litigation to enforce the arbitration provision of this Agreement or an arbitration award) will pay its own fees, costs, and expenses, including attorney's fees, and will equally split the arbitrator's fees and administrative fees of arbitration.

16. Dispute Resolution: This Agreement will be construed under Florida law. All controversies, claims, and other matters in question between the parties arising out of or relating to this Agreement or the breach thereof will be settled by first attempting mediation under the rules of the American Arbitration Association or other mediator agreed upon by the parties. If litigation arises out of this Agreement, the prevailing party will be entitled to recover reasonable attorney's fees and costs, unless the parties agree that disputes will be settled by arbitration as follows:

Arbitration: By initiating in the space provided, Seller ( ), Sales Associate ( ), and Broker ( ) agree that disputes not resolved by mediation will be settled by neutral binding arbitration in the county in which the Property is located in accordance with the rules of the American Arbitration Association or other arbitrator agreed upon by the parties. Each party to any arbitration (or litigation to enforce the arbitration provision of this Agreement or an arbitration award) will pay its own fees, costs, and expenses, including attorney's fees, and will equally split the arbitrator's fees and administrative fees of arbitration.
13. Miscellaneous: This Agreement is binding on Seller's and Broker's heirs, personal representatives, administrators, successors, and assigns. Broker may assign this Agreement to another listing office. This Agreement is the entire agreement between Seller and Broker. No prior or present agreements or representations will be binding on Seller or Broker unless included in this Agreement. Electronic signatures are acceptable and will be binding. Signatures, initials, and modifications communicated by facsimile will be considered as originals.

The term "buyer" as used in this Agreement includes buyers, tenants, exchangers, optionees, and other categories of potential or actual transferees.

### Line 150

#### 4. Additional Terms:
Enter any additional terms or agreements with the seller that are not covered elsewhere.

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>157+</td>
<td>Seller's Signature: ____________________________ Date: ____________________________</td>
</tr>
<tr>
<td>158</td>
<td>Home Telephone: ____________________________ Work Telephone: ____________________________ Facsimile: ____________________________</td>
</tr>
<tr>
<td>159</td>
<td>Address: ____________________________</td>
</tr>
<tr>
<td>160</td>
<td>Email Address: ____________________________</td>
</tr>
<tr>
<td>161+</td>
<td>Seller's Signature: ____________________________ Date: ____________________________</td>
</tr>
<tr>
<td>162</td>
<td>Home Telephone: ____________________________ Work Telephone: ____________________________ Facsimile: ____________________________</td>
</tr>
<tr>
<td>163</td>
<td>Address: ____________________________</td>
</tr>
<tr>
<td>164</td>
<td>Email Address: ____________________________</td>
</tr>
<tr>
<td>165</td>
<td>Authorized Sales Associate or Broker: ____________________________ Date: ____________________________</td>
</tr>
<tr>
<td>166</td>
<td>Brokerage Firm Name: ____________________________ Telephone: ____________________________</td>
</tr>
<tr>
<td>167</td>
<td>Address: ____________________________</td>
</tr>
<tr>
<td>168+</td>
<td>Copy returned to Seller on ____________________________ by ☐ email ☐ facsimile ☐ mail ☐ personal delivery.</td>
</tr>
</tbody>
</table>

#### Lines 170-177
Have the primary seller date and sign on line 170. Write in all of the seller's telephone numbers: home, work, cell, and fax. It is critical that you have all available contact information. Write in the seller's address if it is different from the address on the listing agreement. Enter the date and have the seller sign. Enter the information if there is another seller. (Remember to enter N/A if there is no information to enter. You can't leave a space blank.)

#### Lines 178-180
Enter the date and sign your name. Enter the name, phone number, and address of your brokerage firm.

#### Line 181
Enter the date that a copy of the listing agreement was delivered to the seller. Check the applicable box for the method of delivery.

**Note:** Remember to initial the bottom of each page.
SERVICING THE LISTING

Communication

It might seem to most people that the major dissatisfaction that sellers have with real estate licensees is their failure to sell the property during the listing period. However, the truth is that the primary criticism sellers have about their brokers is, actually, lack of communication. Sellers often complain that once the listing agreement is signed, the broker puts up a sign in the yard and then disappears.

Their home becomes one of many properties on the market that may be shown occasionally. The sellers find a business card on a table indicating that someone came through, but they often don’t get feedback on how the showing went. Sellers can feel cheated or angry when the person who so powerfully presented the reasons why he or she should get their listing seems to be so unavailable once the papers have been signed.

One reason sellers may start having negative feelings is that the broker did not effectively prepare them for what would be happening during the first days of the listing period and beyond. During the first few days, you are doing numerous property marketing tasks of which your sellers may not be fully aware, such as preparing flyers and ads, getting the property information into the MLS, etc. While you are busy being busy, your sellers are at home waiting for the rush of potential buyers, which usually doesn’t happen in the first days.

With a little planning and forethought, you can make your seller feel like a partner in the selling process by keeping the lines of communication open and flowing. Once you have secured the listing, tell your seller what to expect in the first few days. Here are a few things you can do to help them.

TIPS!

- Inform them that your broker will be sending them a letter. Most brokers send a “thank you for listing with our firm” letter to new clients to introduce themselves and to invite the seller to call the broker directly if any problems occur.

- Before you leave the house, install a lockbox. The lockbox holds the key to the home. Brokers can access the lockbox either by using a special lockbox key or an electronic keycard. Install the lockbox on the doorknob, a metal railing, or some other stationary object. Electronic lockboxes keep track of who opened the property, and when, thus making it easier for you to follow up with the broker if necessary.

- Meet with the seller a day or two after the listing appointment to go over your specific marketing plan with them. At this meeting, go through the home again to re-familiarize yourself with its features and make note of any particular suggestions you might have.

- Throughout the listing period, continue to give your client tips, ideas, or suggestions on what they can do to help market the property. Keep them aware that selling their home is a team effort.

- Install a sign in the front yard. Signs attract buyers and since your phone number is on the sign, the buyer will contact you, opening the door for you to handle both sides of the transaction. The seller will also get more activity on their home. It’s a win-win for both you and the seller.
Weekly Activity Report

An important part of your seller communication is a weekly activity report. Many licensees choose to send a monthly report because it looks like there has been more activity. Remember, frequent communication with your seller is vital, so the weekly contact is best. Let your seller know that your weekly report will include:

- Number of inquiries on the property that week
- Number of showings
- Advertising done that week
- Open houses held and the number of visitors
- Comments made by other agents or prospective buyers

You can also send along copies of any ads you placed that week, a copy of the MLS pages, copies of pages from any websites where the property has been listed, and information about any e-mails that you sent to promote the home.

TIPS!

It’s critically important to maintain contact with your seller, even during those weeks when there has been little or no interest in the property.

Advertising Plan

Be sure to share your advertising plan with your seller. They need to know the schedule of when and how you will advertise their property.

Flyers

Flyers are also called property briefs. These printed pieces describe the home’s features. They usually have at least one photo, sometimes several. They also include any Internet address where potential buyers can get more information about the property. Leave a large supply of flyers at your seller’s home, so each visitor can pick one up. You can use the flyers in several other ways, as listed below:

- Place in information boxes or tubes attached to the For Sale sign.
- Distribute at open houses.
- Deliver to brokers from other offices.
- Distribute to your own firm’s brokers.
- Mail out in response to telephone or e-mail inquiries.

Classified Ads

Prepare a number of good classified ads so you can avoid repetition when you’re on a short deadline. Also, prepare an open house ad and one for use in a homebuyer’s guide if your firm uses real estate guides as an advertising venue.

A time-tested method for writing good advertising is referred to as the AIDA standard. The AIDA standard says that if you want your ads to get results, they must capture the reader’s Attention, arouse Interest in your product, create a Desire for the product, and then prompt the reader to Action.

A = Attention
I = Interest
D = Desire
A = Action
• **Attention.** In order for your ad to capture the attention of the reader, it must look different from all of the other real estate ads in that same media. Your ad should be attractive enough to encourage the readers to keep reading. Whatever you choose to do, this step is critical. You can’t deliver your message to the reader until you’ve grabbed his or her attention.

Some suggestions include:

- Try using **bold type**, all CAPS, or a **unique-looking font** for the headline. Headlines are read 10 times more often than the body of an ad, so make sure yours is a good one.
- Use color, if available. (Refer to an earlier section in this book.)
- Be clever. Asking a question or making a bold statement as your headline could work well.
- Vary the layout, making use of white space in creative ways.

• **Interest.** Once you’ve captured the reader’s attention, you need to keep it to arouse interest. One of the best ways to stimulate interest is to peak the reader’s curiosity about what you are offering. Excite the reader’s imagination with statements that allow them to picture themselves in the setting, enjoying the features and benefits of the property. Some examples are:

- Entertain friends and family in the state-of-the-art home theater.
- Relax while enjoying your favorite beverage on the deck of the large swimming pool.
- Tuck yourself into the quiet of the den/library with its unique free-standing fireplace.
- Delight in the luxury of the two-person whirlpool tub.

• **Desire.** Once you have the reader’s attention and interest, the ad must continue to paint a picture of the property that will appeal to the reader’s emotions, thereby creating desire for the property. The ad must build the reader’s desire to see the property. By using clear and concise language, you’ll tell the reader what they need to know to be able to picture themselves as the owner of the property. Avoid exaggeration; just use the facts. Your ad should inspire the reader’s confidence in your firm and your product.

• **Action.** If you have succeeded in generating attention, interest, and desire, your ad should then prompt action from the reader. The actions you want your reader to take include:

- Call you or your office
- E-mail you or your office
- Visit your office
- Visit your website
- Attend an open house

**TIPS!** Be sure to include your contact information in all of your ads. It’s the only way to track them for results.
Multiple Listing Service (MLS)

Take the time to enter the listing into the MLS correctly with all of the property details, professionally written remarks, detailed directions, and up to 28 color photos. Typically, numerous properties will come up during an MLS search and the broker will look through the full listing sheets, glancing at the remarks to find the best choices to show to the buyers. The broker cannot show all of the properties on one showing date, so you’ll need to catch the attention of the agent immediately. You want to get your listing on the brokers’ short list, so make your listing stand out by sounding better than the others do.

Try to think of every aspect of the property that is good, inviting, attractive, functional, beneficial, valuable, and so on, and state it in a strong, direct, and concise way in the MLS remarks. Use creative and descriptive words. Aspects to promote are location, view, neighborhood/building, kitchen, baths, master suite, and terrace - just to name a few.

Send the information on your new listings to the MLS as soon as possible, so that other brokers will have the information quickly. Once the listing is uploaded to the MLS, print a copy and send it to your seller as part of your weekly activity report.

Your Web Site

Place your new listing on yours or your company’s Web site as soon as possible after obtaining the listing. As with the MLS, as soon as you have uploaded the property information, print a copy and send it to the seller with the weekly activity report.

Home Tours

Home tours, also known as caravans, are very beneficial to familiarize brokers with the new listings. They are usually set up as morning tours on a weekly basis. There are two types of home tours:

- **Office tours.** The brokers and associates from your firm tour the property. It’s useful to have the licensees fill out a property evaluation form after they do their walkthrough. These evaluations give you helpful information to share with your sellers – both the positive aspects and those things the other licensees see as areas that need improvement.

- **MLS tours.** Many listing services set up tours for brokers by area, since there are usually too many listings for any broker to see in a morning’s time. If your listing is on an MLS tour, have property evaluations available for the brokers to fill out.

Showings

Sellers are most familiar with the showing aspect of marketing their property, so be sure to inform them of how things could go.

Examples:

Even though in most cases a seller will have ample warning when a showing is scheduled, they should be prepared for that unexpected, last minute call. Sometimes agents are actually out showing property to buyers when they realize that a certain home has the features the buyers are looking for. They might then call the listing agent to see if they can schedule a last minute showing.
Another illustration is the case of buyers out riding around and seeing a home that peaks their interest. The buyers will call the agent while sitting out in front of the home and ask if they can see it. It’s not ideal, but it does happen and sales have resulted from such situations.

If someone knocks on the door and wants to see the property, tell your seller to get the person’s name and then call your office immediately so a broker can meet the potential buyer at your home to conduct the showing.

On the other hand, sellers need to understand that there will be situations in which you or another broker will have to cancel a scheduled showing. You must promise your seller that you will make every effort to give them warning when a showing has been canceled. However, circumstances do exist when an agent will not show for a scheduled appointment and the listing agent will not know until the seller calls to report it. Reassure your clients that if this happens, you will do whatever you can to find out why and let them know.

Whether the situation involves a last minute showing or a canceled appointment, it’s important for your seller to realize that flexibility will help keep such situations from becoming unduly stressful.

**Open Houses**

- **Broker open house.** A broker open house is an open house for licensees only. This type of open house is useful because it gives you the opportunity to get feedback regarding your listing from licensees, as well as get the property in front of more of them. It’s especially valuable for properties that are unusual. Licensees typically like to attend these events. It gives them a chance to spend more focused time at a property that could very well meet the needs of one of their buyers.

  Holding a drawing or raffle for a prize, such as a set of free car washes or a gift certificate to a popular restaurant, is an incentive that the hosting broker can use to attract more licensees to the open house.

  A raffle is easy to conduct. Have the licensees drop their business cards into a bowl or basket. At the end of the open house, draw the winning card.

  Now that you have the business cards from everyone who attended, you can contact the licensees to get their feedback, or to see if they have any interested buyers.

- **Public open house.** A public open house is the most familiar form of open house to licensees, buyers, and sellers. Here are some tips to help you to have a successful open house:

  o With any open house or home tour, encourage the seller to have their home in the best possible condition – clean and uncluttered.

  o Have each visitor sign in and let you know why they came. You can design your sign-in sheet to ask if the visitor is represented by a broker, so that you can find out if this person might be a potential client for you.

  o Be sure to give each visitor a copy of the property flyer and your business card. You should also have flyers available for other comparable homes in this area in lower price ranges.
Communicate any comments you receive from attendees to your seller in your weekly activity report.

Another idea is to have a summary sheet prepared by a loan originator to demonstrate financing options for the house. The document could have columns showing the differences for conventional loans at 5%, 10%, 20%, and an FHA loan. After all, buyers are interested in three things when looking to purchase a home:

1. How much is the monthly payment?

2. Do we make enough income to afford a house in this price range? (Do we qualify?)

3. How much cash do we need to qualify for financing?

A loan comparison chart, like the one shown below, may provide answers.

<table>
<thead>
<tr>
<th>Loan Program</th>
<th>Conventional Fixed Rate</th>
<th>Conventional Fixed Rate</th>
<th>Conventional Fixed Rate</th>
<th>FHA 203b</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balloon in Months</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Down Payment</td>
<td>5.00%</td>
<td>10%</td>
<td>20%</td>
<td>-2.19%</td>
</tr>
<tr>
<td>Term in Months</td>
<td>360</td>
<td>360</td>
<td>180</td>
<td>360</td>
</tr>
<tr>
<td>Note Rate</td>
<td>7.125%</td>
<td>7.125%</td>
<td>6.875%</td>
<td>7.250%</td>
</tr>
<tr>
<td>Sale Price</td>
<td>$136,900.00</td>
<td>$136,900.00</td>
<td>$136,900.00</td>
<td>$136,900.00</td>
</tr>
<tr>
<td>(Less) Loan Amount</td>
<td>$130,050.00</td>
<td>$123,200.00</td>
<td>$109,500.00</td>
<td>$139,900.00</td>
</tr>
<tr>
<td>(Less) Other Financing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Down Payment</td>
<td>$6,850.00</td>
<td>$13,700.00</td>
<td>$27,400.00</td>
<td>($3,000.00)</td>
</tr>
<tr>
<td>Plus Closing Costs</td>
<td>$3,817.00</td>
<td>$3,745.00</td>
<td>$3,601.00</td>
<td>$3,953.00</td>
</tr>
<tr>
<td>Plus Prepaid Expenses</td>
<td>$1,784.00</td>
<td>$1,610.00</td>
<td>$1,175.00</td>
<td>$1,816.00</td>
</tr>
<tr>
<td>(Less) Paid by Seller</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Less) Deposits and Other</td>
<td>$0.00</td>
<td>$0.00</td>
<td>$0.00</td>
<td>$0.00</td>
</tr>
<tr>
<td>Cash Required for Closing</td>
<td>$12,451.00</td>
<td>$19,055.00</td>
<td>$32,176.00</td>
<td>$2,769.00</td>
</tr>
<tr>
<td>First Mortgage (P&amp;I)</td>
<td>$876.17</td>
<td>$830.02</td>
<td>$976.56</td>
<td>$975.83</td>
</tr>
<tr>
<td>Other Financing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hazard Insurance</td>
<td>$54.19</td>
<td>$51.33</td>
<td>$45.63</td>
<td>$59.60</td>
</tr>
<tr>
<td>Real Estate Taxes</td>
<td>$121.25</td>
<td>$121.25</td>
<td>$121.25</td>
<td>$121.25</td>
</tr>
<tr>
<td>Mortgage Insurance</td>
<td>$84.53</td>
<td>$53.39</td>
<td>$0.00</td>
<td>$58.03</td>
</tr>
<tr>
<td>Homeowner Dues</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Housing Expense</td>
<td>$0.00</td>
<td>$0.00</td>
<td>$0.00</td>
<td>$0.00</td>
</tr>
<tr>
<td>Total Monthly Payments (PITI)</td>
<td>$1,136.14</td>
<td>$1,055.99</td>
<td>$1,143.46</td>
<td>$1,214.71</td>
</tr>
<tr>
<td>Suggested Minimum Income</td>
<td>$4,058.00</td>
<td>$3,771.00</td>
<td>$4,084.00</td>
<td>$4,338.00</td>
</tr>
</tbody>
</table>
CHAPTER 4 REVIEW QUESTIONS

1. The three keys to prospecting success are _________ of contacts, _________ of contacts, and _________ for tracking contacts.

2. It is important to maintain a contact _________ containing all your prospect contact information. Using _________ is key to managing and accessing this information.

3. A _________ is a specific geographic location, subdivision, or area in which you choose to concentrate your real estate activities.

4. _________ marketing is the traditional form of marketing that includes newspaper, radio, or television ads as well as flyers and mailers. _________ marketing includes any form of social media where relationships are developed that attract the client to you.

5. _________ advertising is any type of ad that is put in front of consumers where the results cannot be measured, such as billboard ads. _________ advertising is any type of ad where the results can be measured, such as pay-per-click online ads.

6. The cover of the listing presentation manual should display a picture of the seller’s _________ with the seller’s _________ and _________, and your _________ information.

7. The listing presentation should include an up-to-date personal profile. The profile should include your _________, _________, _________, and community involvement.

8. It is important to qualify the seller by asking questions to help you understand their _________ for selling and _________ regarding timing, asking price, moving plans, and financing.

9. A _________ is an employment agreement between you and a property owner. It may not contain an _________ clause.

10. An _________ listing is a _________ contract where the owner agrees to pay a commission to any broker who provides a ready, willing, and able buyer under price and terms agreeable to the owner.

11. An _________ listing is a type of listing where the owner can list the property with only one broker. But, the owner can sell the property on their own without owing the broker a commission.

12. A broker is best protected by an _________ listing, where the owner can list with only one broker and must pay the broker commission regardless of who sells the property.

13. A _________ listing sets a minimum amount that the seller wants to receive from the sale, exclusive of the broker’s commission.

14. In servicing the listing, the number one complaint clients have about their real estate professional is lack of _________. To avoid this problem, always prepare them for events and keep them informed of the status of the sale and any items that may require their attention.

15. A time-tested method for writing good advertising is referred to as the _________ standard, which says that if you want your ads to get good results, they must capture the reader’s _________, arouse _________ in your product, create a _________ for the product, and prompt the reader to _________.
CHAPTER 4 PRACTICE EXAM

1. Which of the items listed below is NOT a necessary item to bring to a listing presentation?
   a. Listing presentation manual
   b. Seller’s property disclosure statement
   c. Purchase and Sale contract
   d. Listing agreements with seller’s information, except for asking price

2. Which service would NOT be appropriate to list in your marketing plan as one of the services you provide to the seller?
   a. Help you determine the best asking price.
   b. Present and discuss each offer with you.
   c. Guarantee to find a buyer who will pay your asking price or higher.
   d. Contact you regularly to keep you fully informed.

3. Which home preparation tip would NOT be recommended?
   a. Keep family photographs and personal items in view to give the home a welcome appearance
   b. Clean or paint the front door and polish door hardware
   c. Organize and clean out closets to make them look larger
   d. Clean and freshen up the bathrooms, including removing any mold or mildew from the tub or shower area

4. Which of the following is an example of a call to action statement?
   a. We provide the best service in town.
   b. Call now.
   c. We have a number of new listings in the Broward County area.
   d. All of our agents receive special residential listing training.

5. If you have a potential buyer for a FSBO property, what type of document might you use to negotiate a showing?
   a. Open contract
   b. Closed contract
   c. Optional contract
   d. One-time showing contract

6. In which section of your listing presentation do you have the specific information about how you are going to market a client’s property?
   a. Mission statement
   b. Personal resume
   c. Listing agreement
   d. Marketing plan

7. Which type of listing allows an owner to list his or her property with only one broker?
   a. Exclusive listing
   b. Open listing
   c. Closed listing
   d. Single listing

8. Under what listing agreement is the broker assured compensation regardless of who sells the property?
   a. Open listing
   b. Exclusive right of sale listing
   c. Fixed listing
   d. Exclusive listing

9. Which action would NOT be recommended for a successful listing presentation?
   a. Be on time
   b. Build rapport with the seller through some casual conversation
   c. Ask relevant questions to gather information about the seller’s needs
   d. Dress very casually to encourage the seller to feel comfortable with you

10. What is the best strategy to take when there has been no activity on the listing in the past week?
    a. Avoid contacting the client.
    b. Contact the client and misrepresent the truth.
    c. Contact the client and discuss the status.
    d. Do nothing; wait and send a monthly report that shows more activity.
11. **Why is an Exclusive Right of Sale listing advantageous to a broker?**
   a. The broker can charge a higher rate of commission.
   b. The broker can place the listing in the MLS.
   c. The broker’s compensation is best protected.
   d. A seller can use multiple brokers.

12. **Which question would NOT be suggested when qualifying the seller?**
   a. Is there any particular type of buyer would you like me to locate?
   b. Why and where are you moving?
   c. What improvements have you made to your home?
   d. What timeframe do you have in mind for selling your home and moving to a new home?

13. **A seller’s cancellation fee is found in which section of the Exclusive Right of Sale listing contract?**
   a. Fee termination
   b. Penalty fee
   c. Conditional termination
   d. Expense termination

14. **Which of the following is NOT a suggested property-staging tip?**
   a. Play quiet background music.
   b. Turn the room temperature 72°F.
   c. Open the drapes and turn on all the lights.
   d. Turn on the TV.

15. **Which information is NOT included in an Exclusive Right of Sale listing agreement?**
   a. Authority to Sell Property, including beginning and end dates of the agreement
   b. Price and Terms, including the minimum price the seller is willing to accept
   c. Brokerage Relationship, including a disclosure your agency relationship to both buyers and sellers
   d. Broker Obligations and Authority, including seller’s agreement to list the property on the internet or use a lock box
This Page was Left Blank Intentionally.
To help buyers choose the best available method of financing, today’s real estate professional needs to have a thorough understanding of the financing process and options. The size of a loan that a buyer can obtain certainly depends on that buyer’s personal financial circumstances. It also depends on the features and structure of the loan. These are the important questions to ask. How long is the repayment period? How much of a down payment will the lender want? Does the loan carry a fixed or adjustable interest rate?

The types of loans that lenders make at any point in time vary in order to accommodate the changing conditions in the mortgage finance market. Lenders are interested in giving loans to qualified buyers, but they must structure those loans to control the risk of a buyer’s default and to protect their own investments.

As a real estate professional, you can help your buyers obtain the needed financing by keeping up with the kinds of loans that are currently available in your market. Oftentimes, lenders will send out information about their latest loan programs. In addition, you can stay up-to-date by doing frequent internet searches for the newest developments.

After completing this chapter, you should be able to do all of the following:

- Identify types of lenders in the primary mortgage market
- Explain the function of the primary and secondary mortgage markets
- Identify key lenders in the secondary mortgage market
- Describe the basic features of a mortgage loan
- Explain the key differences between conventional, FHA, and VA loans
- Describe amortization of loan payments in conventional loans
- Identify conventional loan options
- Describe the ratios used by lenders to qualify borrowers
- Identify buyer protections put in place by the Truth in Lending Act
- Describe the loan application process

By definition, an institutional lender is any financial institution whose loans and lending practices are regulated by law. These institutions pool the funds of their depositors and invest the funds in real estate loans, making them financial intermediaries. Institutional lenders include commercial banks, savings associations, life insurance companies, and pension funds.

A noninstitutional lender is an entity whose real estate loans are not so strictly regulated by state or federal government agencies. A large variety of noninstitutional lenders exists in the real estate marketplace. This is not surprising, given the fact that noninstitutional lenders are relatively free of regulations. Examples of noninstitutional lenders include private parties, syndications, private loan companies, and endowment funds.
Institutional vs. Noninstitutional Lenders

Institutional and noninstitutional lenders are different in the following significant ways.

- **Degree of regulation.** Institutional lenders are highly regulated by state and federal agencies; noninstitutional lenders have few, if any, regulations.

- **Direct investment vs. intermediary.** As stated above, institutional lenders are financial intermediaries; noninstitutional lenders invest their funds directly rather than through an intermediary.

- **Impact of usury laws.** Institutional lenders are not subject to usury laws, which are laws that protect consumers by limiting the rate of interest that may be charged. Therefore, institutional lenders may charge any rate of interest. Noninstitutional lenders make loans that may be subject to usury laws, thereby limiting the rate of interest that may be charged.

- **Ability to make certain government loans.** Many institutional lenders may make VA and FHA loans, while most noninstitutional lenders may not. Government loan programs are discussed later in this chapter.

- **Availability of secondary mortgage market.** Institutional lenders have the secondary mortgage market available to them, while noninstitutional lenders do not. The secondary mortgage market is a large and liquid market where loan-servicing rights are bought, assembled into one or more packages, and sold to investors.

- **Ability to provide rate “lock-in” period.** Many institutional lenders can offer their borrowers a “lock-in” period on their rates, meaning that they guarantee a particular rate for a two- to eight-week period prior to closing. Noninstitutional lenders typically do not offer this option.

**The Primary Mortgage Market**

The primary mortgage market is where borrowers and mortgage originators come together to negotiate terms and effect mortgage transactions. Loan origination is the process by which a borrower applies for a new loan and a lender processes that application. Origination generally includes all of the steps from the point of taking a loan application up to disbursal of funds or the declining of the application. Mortgage loan originators, mortgage bankers, credit unions, and banks are all part of the primary mortgage market.

The primary mortgage market consists of individuals and businesses that want or need to borrow money and the various sources for those loans. The sources may be individuals, institutional lenders, and other organizations formed to loan money as agents or intermediaries for insurance companies or pension funds. Mortgage loan originators, mortgage bankers, credit unions, and banks are all part of the primary mortgage market.
The primary mortgage market includes the following sources for loans.

- **Commercial banks.** A *commercial bank* is a financial institution designed to act as a depository for funds and as a lender for commercial activities. Commercial banks primarily do short term loans, mostly to businesses to finance their operations. Commercial banks are stock companies, owned by their stockholders.

  Most of the funds deposited in commercial banks are in *demand accounts* (personal and business checking accounts). Since this money is cash, a depositor can withdraw it at any time. As a result, the bank rarely uses these highly fluid funds for mortgage lending.

  On the other hand, the depositors' savings accounts, referred to as *time deposits*, provide access to less liquid funds. These deposits, along with loans from other banks and bank owners' equity, give the bank the access to long-term funds that it needs for its investment ventures, including real estate loans.

  Commercial banks operate under a state or federal charter. The Florida Office of Financial Regulation licenses state-chartered commercial banks, while the Office of the Comptroller of the Currency (OCC) gives licenses to nationally chartered commercial banks. All Florida banks are required to have Federal Deposit Insurance Corporation (FDIC) insurance.

  Although commercial banks make some long-term real estate loans, the largest impact of commercial banks in the real estate market is that they make short-term construction loans. These construction loans include short-term loans that last from three to twelve months, home improvement loans that extend up to five years, and manufactured housing loans that typically run ten years, or sometimes longer, depending on how permanently the home is attached to the property.

  Commercial banks also make other real estate loans, typically for single-family residences. They can make home loans of up to 95% of the home’s value for as long as a 30-year term. However, banks will usually require *private mortgage insurance (PMI)* on any loan of more than 80% of the home’s value. PMI protects the lender in case the borrower defaults on the loan. Refer to the PMI section in this chapter for further details.

- **Savings associations.** *Savings associations*, also known as *savings banks or thrifts*, were originally organized to assist members with the financing of residential property. Previously referred to as *savings and loan associations*, they were designed to serve only their own members. The association members would pool their money and take turns using the money to fund construction of member’s homes. After all the members built homes, the association was dissolved.

  Savings and loan associations dominated the residential mortgage market until deregulation of the banking industry in the 1980s. In the past, these institutions made most of their mortgage loans with depositors’ funds. The loans were held full term, with the savings association receiving the principal and interest payments from the borrower.

  After deregulation in the 1980s, many savings and loan associations faced severe problems because of bad loans, poor decisions about the economy, fraudulent activities, and numerous other factors. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was passed by Congress to reorganize financial institutions in an effort to prevent a repeat of this crisis. The Resolution Trust Corporation (RTC) was formed to manage insolvent...
thrift institutions and sell their assets. After completing the task of selling the
assets of failed savings and loan associations, the RTC was closed in December
of 1996.

Today, a savings association can be organized either as a stock organization
owned by stockholders or as a mutual association owned by the depositors.
Savings associations provide both savings accounts (time deposits) and
**negotiable order of withdrawal (NOW)** accounts (demand accounts) which are
the equivalent of a checking account.

Savings associations are required to hold a minimum percentage of assets as
mortgage-related loans to maintain a status that will allow them to borrow from
the Federal Home Loan Bank System. These institutions extend business and
consumer loans, but in far smaller numbers than their real estate loans. Savings
institutions can make collateral loans that are secured by borrowers’ savings
accounts, savings certificates, bonds, other existing secured notes, or other
forms of readily liquid assets. Savings associations often offer their depositors a
higher rate of interest on their deposits than commercial banks.

Savings associations are chartered either by the federal government or by
the states in which they operate.

The Office of the Comptroller of the Currency (OCC) regulates federal
savings associations and establishes loan limits and reserve requirements.
Federal savings associations are members of the Savings Association Insurance
Fund (SAIF) that insures depositors’ accounts for up to $250,000. The SAIF is a
division of the Federal Deposit Insurance Corporation (FDIC). The savings
association must include the designation “Federal” or “FA” in their name.

State-chartered savings associations can choose to be regulated by the OCC
and have their deposits insured by the SAIF, or to be regulated by the states in
which they are located. If they choose federal regulation, they must abide by the
same rules as federally chartered organizations.

- **Life insurance companies.** *Life insurance companies* hold a major portion of
  the savings of the American public. Only savings associations control more
  savings than life insurance companies do. Life insurance companies are the
  largest source of funds for financing both apartment projects and commercial
  properties. They are a major source of credit for shopping centers, office
  buildings, hotels and motels, industrial buildings, and large apartment
  complexes. They typically invest up to a third of their assets in real estate loans.

  Life insurance companies are organized in one of two ways:

  - **Mutual companies** owned by the policyholders who share in the
    earnings through premium rebates

  - **Stock companies** owned by stockholders who receive dividends on the
    earnings

  In either form of organization, the insurance companies are licensed by the
  state where they have their home office or in which they are incorporated. In
  Florida, insurance companies are regulated by the Florida Office of Insurance
  Regulation.

  Insurance companies are very concerned with the safety and stability of an
  investment over the long term. This is the reason that they typically prefer to
  finance larger real estate projects. However, more recently, they have become
  active in the financing of single-family residences with the assistance of
  mortgage bankers and brokers.
Private parties (individuals). Private parties have no formal structure. They are noninstitutional lenders and have very few laws or regulations to deal with concerning their lending practices. Since there is not much structure, the practices and policies of private parties vary greatly from one lender to another. However, many states have passed usury laws that regulate the maximum amount of interest an entity can charge on various loans.

Florida enacted a liberal system when it comes to usurious lending practices. It ranks as one of the most liberal laws in the country when it comes to what lenders can charge in the way of interest on personal loans. The State of Florida established a two-tier system when it comes to usury limitations on loans. Lenders may not charge an interest rate of more than 18% on loans up to $500,000. On loan amounts above $500,000, the interest rate must not exceed 25% annually. Charging an interest rate that exceeds the maximum amount is illegal and is referred to as usurious. To charge or receive interest at a rate of 25% to 45% per annum is a misdemeanor of the second degree, which could result in imprisonment for up to 60 days. Charging or receiving interest at a rate above 45% per annum is defined as loan sharking and is a third degree felony, which could result in imprisonment of up to five years. [F.S. 687.02]

In some cases where a lender has been found guilty of usury, the borrower did not have to pay any interest on the loan.

Real estate investment trusts. The real estate investment trust (REIT) was formed in 1960 by federal tax law. The goal was to influence small investors to combine their resources with others to raise venture capital for real estate transactions.

REITs are formed by private investment groups to purchase real estate for investment, and to make short-term construction loans and long-term mortgage loans. A REIT is a business trust that operates similarly to a mutual stock fund in that individual investors make investments in the trust, thereby creating a pool of money that can be used to purchase, construct, or fund its real estate ventures. Its investments and loans are primarily in apartment complexes and commercial properties. If qualified, a REIT receives special tax treatment under federal income tax laws.

REITs can be categorized according to the purpose of the formation. Those that are formed to buy, own, and manage investment properties are called equity trusts. Others that are formed for the purpose of lending money to fund the construction and/or purchase of commercial or apartment projects are called mortgage trusts. Trusts that engage in both lending and ownership activities are called mixed trusts.

REITs enjoy special income tax benefits similar to those granted to mutual funds. They are exempt from corporate tax if they invest at least 75% of their assets in real estate and distribute 95% or more of their annual real estate income to their investors. Because the tax incentives are so favorable, real estate investment trusts draw literally thousands of investors.

REITs concentrate on income-producing properties and generally diversify their holdings with regard to both property type and geographical location. REITs prefer to target their lending activities towards land development projects and permanent financing for condominiums, high rises, warehouses, office complexes, single-family subdivisions, and other major projects. Today, REITs play a major role in the development, financing, and ownership of large apartment complexes and commercial properties.
• **Syndications.** A syndicate is a group of two or more people who unite their resources for the purpose of making and operating an investment. Members of the syndication can pool their capital to finance a real estate transaction or to purchase a piece of property.

  Syndication is not a form of legal ownership; rather, it is a term that is used to describe multiple ownership of an investment. Syndicates may operate in the form of a real estate investment trust, corporation, general partnership, limited partnership, or tenancy in common.

• **Private loan companies.** *Private loan companies* are prevalent in this country. Some are very large national firms with branches in hundreds of cities across the country. Others are much smaller, individual operations. In either case, these lenders deal mostly in junior financing; that is, second deeds of trust that allow borrowers to pull out some of the equity in their property to use for other purchases.

  Some of these private loan companies deal exclusively in real estate funding. They can make loans from their own or borrowed funds, they can act as brokers between borrowers and lenders, and they can buy and sell junior financing instruments.

  Private loan companies typically charge more in interest than other lenders. They also tend to charge higher loan placement fees. These practices help the loan companies offset the risks that come with dealing in junior loans.

• **Pension funds.** *Pension funds* collect contributions from workers and sometimes employers and then invest those funds to create a large money pool from which the workers may withdraw when they reach retirement. Traditionally, pension funds have been invested in stocks and bonds and this continues to be the case for the most part. More recently though, since mortgage-backed securities have become available, pension funds have begun to play a role in the real estate market by purchasing existing real estate loans in the secondary market. In addition, some funds are now developing their own programs that allow the fund contributors to use pension funds to purchase homes.

• **Endowment funds.** An *endowment*, in the financial world, is a transfer of money or property, which is donated to an institution, with the stipulation that it be invested, keeping the principal intact. This allows the donation itself to have a much greater impact over a long period than if it were spent all at once, due to compound interest. Since these endowment funds are permanent, fund managers want to choose investments that are safe and will generate relatively high levels of income for long periods. For this reason, endowment funds offer a good source of mortgage financing for commercial and industrial properties. Many commercial banks and mortgage companies handle investments for endowment funds.

• **Credit unions.** *Credit unions* are nonprofit financial institutions into which members place their money, usually through direct deposit. Credit unions pay no income tax, so they can pay higher interest rates on deposits than other savings institutions. They also offer a wide variety of loans at far lower interest rates than their competitors do. This makes credit union membership very attractive.
Credit unions make mostly short-term loans. When they do make real estate loans, they tend to be second mortgages or home improvement loans. Under the Federal Credit Union Act, credit unions have the authority to make 30-year loans to their members to finance a principal residence. They can also make FHA or VA loans at interest rates comparable to market value.

- **Mortgage loan originators.** Mortgage loan originators do not make loans. They arrange loans by taking mortgage applications and searching for lenders who offer the lowest interest rates and easiest borrower qualification. Mortgage loan originators charge borrowers an application fee and often earn a finder’s fee or commission for arranging loans. A mortgage loan originator’s license must be obtained from the Florida Department of Financial Services (DFS) to engage in this business in this state.

  In addition, after the loan is placed, mortgage loan originators do not service the loan. Loan payments are made directly to the lender, although in some cases they could be made to a collection service. In order to establish and maintain a good reputation, mortgage loan originators must take some responsibility for qualifying the borrowers and examining the reliability of the investment. They know that they must recommend reliable borrowers to the lenders and quality loans to the borrowers. Mortgage loan originators must have good access to the major financial institutions that make real estate loans.

- **Mortgage bankers.** Mortgage bankers are financial intermediaries who arrange for the flow of money from investors to borrowers. However, mortgage bankers do not have depositors.

  A mortgage banker is a company, individual, or institution that originates mortgages. After a mortgage is originated, a mortgage banker might keep the mortgage in their portfolio or sell the mortgage to an investor.

  Mortgage bankers may borrow money from a commercial bank by using mortgages it owns as collateral, using the funds to make additional loans, and then selling the loans to another investor. The proceeds of that sale are used to repay the bank loan, which is a process called warehousing.

  Mortgage banks often act as loan correspondents for insurance companies or investment funds. The insurance company or pension fund supplies the money to be loaned; the mortgage banker originates individual loans to local borrowers by using the money supplied by the insurance company or other investor.

  After making the loans, the mortgage banker usually continues to service the loans. Servicing a loan means collecting the payments, escrow the taxes and insurance, keeping the loan records, and forwarding the net proceeds to the investor who supplied the funds in the first place. They charge a fee for servicing the loan and earn additional profit by charging loan origination fees, points, and other fees related to the origination of the loan.

  Mortgage bankers are the largest originators of FHA and VA loans but make conventional and commercial loans as well.
SELLING AND PACKAGING OF LOANS

Mortgage funds can be sold or packaged in a variety of ways.

- Lenders can sell loans to one another.

  Example:

  A Florida savings and loan association has a higher demand for loans than it can meet. A savings and loan association in South Dakota has a surplus of deposits and a low loan demand. If the Florida savings bank sells loans to the South Dakota savings bank, the Florida bank receives the money it needs to make new loans while the South Dakota bank can invest its surplus funds.

- One institution can sell a part interest in a block of loans to another institution. This is called mortgage participation.

  Example:

  Florida has $5,000,000 in loans to sell to South Dakota. Instead of selling the entire block, Florida sells 90% interest ($4,500,000) and retains the other 10%. In this situation, Florida still services the loans and then passes 90% of the mortgage payments to the South Dakota bank.

- Grouping loans into mortgage-backed securities (MBS).

  A more common way of selling and packaging funds is mortgage-backed securities (MBS), which are backed by a pool of mortgages. Governmental, quasi-governmental, or private entities purchase mortgage loans from banks, mortgage companies, and other originators and then assemble them into pools. The entity then issues securities that represent claims on the principal and interest payments made by borrowers on the loans in the pool.

THE SECONDARY MORTGAGE MARKET

A major problem that faces a lender in the primary market is a constant flow of funds in order to continue to provide mortgage loans. A lender can exhaust its ability to make loans if the demand for mortgage money exceeds the amount of deposits received. Primary lenders sell their notes to generate more money to make more loans.

A secondary mortgage market was developed to provide a constant source of funds with which to make real estate loans. This market consists of secondary market lenders who purchase mortgages that originated in the primary mortgage market. Mortgages originated by primary lenders are bundled or packaged and sold to another lender in what is termed a secondary market transaction.

As a result, the secondary mortgage market provides liquidity to the primary market and solves the problem of the primary lender running out of funds. When the loan is sold, the amount that was originally loaned is replaced, thereby allowing the same money to be loaned again. The primary lender makes a profit by retaining the loan origination fees and the points charged to the borrower. It usually continues to service the loan after it has been sold.

The secondary mortgage market consists of holding warehouse agencies that purchase a number of mortgage loans and assemble them into one or more packages of
loans for resale to investors. Investors can purchase fractional interests in these loans or mortgage pools through the services of local stockbrokers. Discounts are used frequently in the secondary market. Entities that buy and sell mortgages negotiate based on yields. Discounts are used to adjust yields, so the buyers and sellers of the mortgage notes can reach agreement and make the sales.

You might wonder why lenders don’t just keep the loans they make instead of selling them on the secondary market. That approach could work if every lender had a balance between the demands it has for loans and the supply of money to which it has access. That is rarely the case. Therefore, loans are sold on the secondary market in an effort to shift money from areas that have a surplus to those areas that have a shortage.

 Investors in the secondary market make a relatively low-risk investment since the primary lender has already qualified the borrowers and the properties. Each lender is requested to provide an estoppel letter thereby confirming the balance of each loan before the loan is sold in the secondary market. Federal lending law requires that each borrower be notified whenever a loan is being sold to another lender. The terms of the original loan are unaffected by the sale.

The federal government has been instrumental in the organization of the secondary mortgage market. The principal secondary lenders are governmental or quasi-governmental agencies and include Ginnie Mae, Fannie Mae, and Freddie Mac.

These agencies, collectively known as government-sponsored enterprises (GSE), purchase loans or guarantee mortgage-backed securities issued by lenders. In September 2008, the Federal Housing Finance Agency (FHFA) placed Fannie Mae and Freddie Mac into conservatorship. This action was essentially a takeover by the government to ensure the financial soundness of these two companies due to the events that took place during the subprime mortgage crises.

### Ginnie Mae (Government National Mortgage Association or GNMA)

Ginnie Mae was originally created as a government-owned corporation operating within the U.S. Department of Housing and Urban Development (HUD). When it was established in 1968, its basic mission was to create and operate a mortgage-backed security program for the FHA and VA mortgages. Ginnie Mae developed the first mortgage-backed security in 1970. This security was backed by a pool of FHA and VA mortgages. It was called a pass-through security because the monthly principal and interest payments were collected from the borrowers and then passed through to the investors.

Ginnie Mae took over the special assistance housing programs authorized by Congress and acts to make low-yield, high-risk loans marketable. Ginnie Mae is primarily engaged in purchasing federally subsidized residential mortgages which are originated by local lenders. It assists in the financing of urban renewal and housing projects by offering below-market interest rates to low-income families. It also guarantees payment of securities backed by residential mortgages.

### Fannie Mae (Federal National Mortgage Association or FNMA)

The Federal National Mortgage Association (FNMA), nicknamed Fannie Mae, was originally created in 1938 as a government-owned corporation for purchasing FHA loans.

FHA, which was created in 1934, helped to revive the construction industry and improve employment. The demand for FHA loans depleted the deposits available in many smaller banks and the lending process could not continue, thus defeating the very
purpose of the program. Fannie Mae was given the authority to purchase these loans so that the program could remain viable.

In 1944, with the inception of the VA loan program, Fannie Mae was authorized to purchase these loans in addition to FHA loans. Fannie Mae continued to be a government-owned - operated corporation.

Under the 1968 Charter Act, Fannie Mae became a for-profit private stockholder-owned corporation operating with private capital on a self-sustaining basis. As a separate, privately owned corporation, Fannie Mae became subject to federal corporate income tax, but it was exempt from state income taxes. The 1968 Act also provided for continuing HUD oversight of Fannie Mae to ensure Fannie Mae's adherence to its public purpose.

In 1970, Fannie Mae's authority was expanded to include the purchase of conventional loans. Today, Fannie Mae uses private capital raised by selling mortgages from its portfolio, and mortgage-backed securities to purchase all types of mortgages, FHA, VA, and conventional. Fannie Mae is the oldest and largest participant in the secondary mortgage market.

Fannie Mae and FHLMC (Freddie Mac, which is discussed in the next paragraph) have encouraged the standardization of lending practices throughout the United States. All loans that are sold to either Fannie Mae or Freddie Mac must be underwritten using criteria and standards established by these organizations. Loans which are underwritten in accordance with their requirements are called conforming loans, and the lenders that originate them are referred to as conforming lenders. Loans that do not conform to their standards for underwriting cannot be sold in the secondary market and must be held by the primary lender as a portfolio loan.

Fannie Mae and Freddie Mac have recently developed a new system for underwriting that is designed to speed up the loan approval process, called desktop underwriting. A local lender that subscribes to this system can input a loan application by computer directly to the secondary market. If the application meets secondary requirements, Fannie Mae or Freddie Mac can grant approval immediately so the loan can be funded almost instantly. Even the appraisal process is being by-passed in select cases. Centralized data banks have been created for high-density metropolitan areas that allow a statistical analysis of a property to be performed without the delay inherent in waiting for an appraisal to be completed. The statistical analysis is backed up by a ratio analysis of tax roll data. The physical appearance and conformity of the property is verified by a drive-by which is performed either by an employee of the lender or by an appraiser who performs a simplified appraisal.

Fannie Mae is a shareholder-owned company that works to make sure mortgage money is available for people across the country. Fannie Mae does not lend money directly to homebuyers. They work with lenders to make sure the lenders don't run out of mortgage funds. Fannie Mae stock is actively traded on the New York Stock Exchange and other exchanges. It is also part of the Standard & Poor's 500 Composite Stock Price Index.

Fannie Mae operates under a congressional charter, which directs it to channel its efforts into increasing the availability and affordability of homeownership for low-, moderate-, and middle-income Americans.

Fannie Mae receives no government funding or backing. When Fannie Mae purchases mortgages, it executes a servicing agreement that allows the loan originator to be the collection agent and receive a fee. The loan originator can receive a potentially substantial income from these fees, which range from 1/4 to 3/8 of 1% of the loan amount. Therefore, the greater the size of the loan portfolio, the greater the income the loan originator receives.

When Fannie Mae sells mortgages, it does so in open-market transactions. Purchasers must pay current prices for the securities in these transactions. Sales of
Fannie Mae mortgages usually peak when there are limited opportunities for other investments.

**Freddie Mac (Federal Home Loan Mortgage Corporation or FHLMC)**

Since Ginnie Mae and Fannie Mae were created to deal primarily with the purchase of FHA and VA loans, there was a need to develop a mortgage-backed security for conventional loans. In 1970, Congress created the *Federal Home Loan Mortgage Corporation (FHLMC)*, known as *Freddie Mac*, which introduced the first security backed by conventional loans.

Freddie Mac is a stockholder-owned, for-profit corporation, which operates as a function of the HUD. Freddie Mac is authorized to purchase all types of loans. Although authorized to purchase FHA and VA loans, Freddie Mac’s activity is primarily in the field of conventional loans. Freddie Mac sells mortgage-backed securities and mortgage loans to investors.

Freddie Mac’s mission is to provide stability, affordability, and opportunity to the housing market. Freddie Mac is dedicated to putting homeownership within reach for minority populations. In addition, Freddie Mac strives to make rental housing more affordable through its mortgage programs for multifamily housing.

**Loan Features**

The basic features of a mortgage loan include loan fees, loan-to-value ratio (LTV), repayment period, amortization, and repayment plan.

**Loan Fees**

In some ways, we can think of a mortgage loan as a partnership between the lender and the borrower. The advantage to the borrower lies in obtaining the funds to complete the home purchase. The lender’s advantage comes from obtaining income in the form of the interest and finance charges on the loan, thus making the loan an investment for the lender. In order to increase the investment, lenders often charge other fees when the borrower gets the loan. The borrower could pay all or some of these charges.

- **Loan origination fee.** The *loan origination fee* is typically 1% of the loan amount, although it could be higher. It covers the lender’s cost for generating the loan.

- **Points or discount points.** *Points* (or discount points) represent prepaid interest. The borrower pays discount points up front to receive a lower interest rate over the life of the loan. The lender charges points to get additional income on the loan. Points are paid at closing. Each point paid is 1% of the loan amount.

**Example:**

2 points on a $150,000 loan is equal to $3,000.

\[($150,000 \times \cdot01 \times 2 \text{ points} = \$3,000)\]

Points are a means of raising the effective interest rate of the loan. This rate actually received is called the *effective yield*. This in turn facilitates the lender’s ability to sell the loan to the secondary mortgage market at competitive rates. The rule of thumb
for calculating effective yield is 1/8% (0.125) for each discount point. Therefore, a
charge of 3 points increases a 6 ¼% mortgage to a 6 5/8% yield.

Example:

3 points x 0.125 = 0.375

6 ¼% (6.25) + 0.375 = 6.625 (6 5/8%)

Loan-to-Value Ratios (LTV)

A loan-to-value ratio, also referred to as LTV, is the ratio of
the mortgage principal to the value of the property the
borrowers are purchasing.

Example:

A buyer purchases a home for $240,000, makes a
$48,000 down payment, and borrows $192,000. The loan-to-value ratio is 80%. The buyer makes a 20% down payment and borrows 80% of the home’s value.

If the same buyer makes a $24,000 down payment on the same loan, the LTV is 90%, since they make a 10% down payment and borrow 90% of the home’s value.

Therefore, a higher LTV means the borrower receives a larger loan amount and makes a smaller down payment.

Most lenders feel that if the borrowers have a greater amount invested in the property (meaning, the down payment); the less likely they will be to default on the loan and lose the property. In addition, if the borrowers do default, the loan balance will be smaller, so the lender will have a better chance of recovering the loan balance in the foreclosure sale.

Lenders use LTV ratios to determine the maximum amount of their loans. In some loan programs, the lender might set the maximum loan amount at 90%, thereby requiring the borrower to make a down payment of 10%, while other programs might allow a maximum of 95%, meaning the borrower would only have to come up with 5% for the down payment.

Repayment Period

The repayment period is the number of years in which a borrower has to repay the loan. It’s also called the loan term. Most residential loans have a term of 30 years, although 15-year and 20-year terms have become more common.

The number of years for repayment has two very important impacts on the loan.

- It affects the monthly payment amount. The longer the repayment period the lower the monthly payment will be.

Example:

The monthly payment on a $150,000 loan for 30 years at 6% is $899.33. The monthly payment on that same amount for 15 years is $1,265.79.
It affects the total amount of interest that will be paid over the life of the loan. The shorter the repayment period, the less the total interest the borrower will pay over the life of the loan.

**Example:**

The total amount of interest paid on our $150,000 30-year loan from the example above is $173,757.28. For a loan term of 15 years, the total interest is $77,841.34.

**Amortization**

*Amortization* refers to how the principal and interest are paid over the life of the repayment period. Most loans made by banks and savings and loans are *fully amortized*. With a fully amortized loan, the borrower has the same payment amount every month. The payment goes first to the interest and then to the principal. Over the life of the loan, the amount that goes toward interest decreases, while the amount that goes to principal increases.

In the early years of the loan, the principal payment is very small, so it takes several years for the borrower to increase their equity in the property. However, closer to the end of the repayment period, the borrower’s equity increases much more quickly.

**Example:**

The monthly payment on a $150,000 30-year loan at 6% is $899.33. When making the first payment, only $149.33 of the payment goes to principal; the remainder goes to interest. However, by year 21 of the repayment period, $524.79 of the payment goes to principal.

**Loan Repayment Plans**

When obtaining a loan, a critical decision for both the borrower and the lender is to determine a payment plan that will suit the borrower’s financial circumstances while remaining a good investment for the lender. There are many types of repayment plans, including the following:

- **Fully amortized, fixed-rate loan.** Most loan payments include a portion that applies to the interest owed and a portion that goes toward repaying the loan, called *principal*. The word amortize comes from the Latin word *amorte*, which means to kill. The amortization, then, is the principal portion of the payment used to repay the loan. Most conventional, FHA and VA loans are amortized loans.

  Most amortized loans are *fully amortizing*, which means the payment is sufficient to repay the interest owed and the loan in full over the life of the loan.

  If the monthly mortgage payment remains the same over the term of the loan, the loan is a *fixed rate or level payment loan*. In each succeeding monthly payment, the amount applied to pay interest on the loan is reduced and the amount applied to repay the loan principal is increased. The principal amount originally borrowed will be completely repaid at the end of the loan term.

  The monthly payment for an amortized loan consists of the following:

  Interest portion + Principal portion = Monthly mortgage payment
A 15-year fixed rate mortgage allows a borrower to save a substantial amount of interest compared to a 30-year or other longer-term loan. However, the monthly payments are obviously higher for a 15-year mortgage loan than those for a 30-year loan are. Lenders will usually make a 15-year loan at an interest rate slightly lower than a long-term loan due to the reduced risk.

- **Partially amortized loan with a balloon payment.** Some amortizing loans are partially amortizing, which means the payment is not sufficient to pay all of the interest due and repay the loan in full. The balance of the original loan that remains unpaid at the end of a partially amortizing loan term is called a balloon payment. This means that the monthly payments are not large enough to fully amortize the loan by the end of the term, thereby leaving the large balloon payment due.

**Example:**

A loan for $125,000 at 5% can be computed on a 30-year amortization schedule but be paid over a term of 20 years. That means the payment amount will be figured as if the loan were a 30-year loan, but the loan will mature and the final balloon payment will be due at the end of the 20th year. In this example, the monthly payment (principal plus interest) is $671.03. At the end of year 20, the balloon payment due is $63,527.64 (the amount of principal still left on the loan).

Other amortizing loans may be structured so that a balloon payment is due after a certain number of years, such as five or seven years. This would allow the payment to remain the same as a fully amortizing loan, but the borrower would have to be in a position to pay the balloon amount when it becomes due.

- **Interest-only loan.** An interest-only loan is a type of mortgage loan in which the borrower is only required to pay off the interest that arises from the principal that is borrowed. Monthly payments are allocated to interest only. No principal is paid off. At the end of the term, the borrower must be able to pay off the entire principal amount (referred to as a balloon payment) or get another loan. Since the payments are applied to the interest only, they remain constant and are typically lower than with other loan types.

An interest-only loan could be a wise choice for someone who plans to own the property for a short time and believes the property will appreciate during that time. Conversely, it could be very risky. If the property does not appreciate, the borrower could end up with less in proceeds on the sale than what is needed to pay off the loan.

Interest-only loans can be useful for first-time homebuyers because it allows young people to defer large payments until their incomes grow.

- **Adjustable rate mortgage (ARM).** An adjustable rate mortgage is an amortized loan in which the interest rate fluctuates over the term of the loan. Payment adjustments are made at set intervals. The lender’s risk associated with making fixed-rate loans is reduced by using an adjustable rate mortgage. Since interest rates can rise, the lender may receive additional income on the loan as the market changes.
Important elements of an ARM loan include an index and a margin. The
margin added to the index determines the note rate, which is the rate the
borrower will pay on the loan. This rate can change for future loans based on
changes in the index.

- **Index.** The *index* is a foundation rate for the loan that must be published
and is beyond the control of the lender. Two index rates often used by
lenders are the weekly average yield on U.S. Treasury Securities called
the *one-year T-bill rate*, and the *eleventh district cost of funds*. Of the two,
the eleventh district cost of funds tends to be less volatile, thereby
resulting in less dramatic changes in the borrower’s payment.

- **Margin.** A *margin* is a percentage that is added to the index rate by the
lender to cover the lender’s overhead and provide a profit on the loan.
The margin does not change for the life of the loan.

The date when interest rates can change in an ARM is called the *rate
adjustment date*. The amount of time between rate adjustment dates is called the
*rate adjustment period*. An ARM with a rate adjustment period every 12 months
is called a one-year ARM, every 36 months is a three-year ARM, and every 60
months is a five-year ARM.

The change date for the borrower’s monthly mortgage payment must be
disclosed to the borrower in advance. Typically, the payment adjustment is made
on the same date as the interest rate.

If the ARM payment does not change on the same date as the interest rate,
*negative amortization* may occur. This is due to the fact that the monthly payment
may be lower than the payment required for principal plus the amount of interest
due. If the interest rate is adjusted monthly, but the payment is only changed
once each year, negative amortization can occur. When negative amortization
occurs, the unpaid interest is added to the loan balance and no reduction in the
principal occurs.

Most ARM loans have both a *payment cap* and a *lifetime cap*. Caps create an
upper and a lower limit on the adjustments that can be made to the loan.
Payment caps set the limit for any single adjustment to the payment. Lifetime
caps set the upper and lower interest rate that can be charged over the life of the
loan. For example, caps of 2 and 6% on a one-year ARM limit the increase or
decrease in the payment to 2% per year and to 6% over the life of the loan.
Adjustments may be made up or down, depending on the change in the
underlying index.

- **Graduated payment loan.** In a *graduated payment mortgage*, the borrower
makes low initial monthly payments that are insufficient to fully amortize the debt
at the end of the mortgage loan term. The monthly payments are periodically
increased during the first three to five years of the loan. Following the last
increase, the payment will be higher than the payment necessary to amortize the
original loan had it been scheduled as a fixed payment mortgage.

During the period that the payments are insufficient to amortize the loan, the
principal balance actually increases as the result of negative amortization. The
interest not paid in the initial payments is added to the principal balance of the
loan. The borrower owes more money after the graduated period than the
original principal balance borrowed.
TYPES OF MORTGAGES

Although there are a number of different methods for repaying a loan, there are only three types of mortgages: conventional, FHA insured, VA guaranteed. The sections that follow provide detailed information about each of these mortgage types.

CONVENTIONAL LOANS

A conventional mortgage loan is any loan that is not insured or guaranteed by an agency of the government. Conventional mortgage loans made by lending institutions, and private lenders are the predominate method in which single-family residences are financed.

Usually, conventional mortgage loans are more difficult for a borrower to obtain than a mortgage under the FHA or VA programs. Conventional mortgage loans typically require a higher down payment than those required by FHA or VA, and traditionally carry a higher interest rate. Since these loans are neither insured nor guaranteed, they carry a higher risk in foreclosure than the FHA and VA loans.

A fixed-rate 30-year mortgage is a common conventional loan. The payment is stable and there is always the opportunity to pay the balance down or to refinance for a better rate later. Recently, 15-year mortgages have become popular as borrowers realize that the interest savings is significant over the 30-year loan.

Private Mortgage Insurance (PMI)

To offset the higher risk, and to allow conventional lenders to compete with FHA and VA loans, private mortgage insurance was developed. Private mortgage insurance (PMI) was introduced by the Mortgage Guarantee Insurance Corporation (MGIC) in 1957 and is currently available from several competing firms. Federal lending regulators usually require PMI when the loan amount exceeds 80% of the property value. Some lenders qualify for self-insurance, and in that event, do not require PMI. However, they may charge the borrower a fee for this protection. With PMI, a conventional borrower may obtain a loan for up to 95% of the property value.

The federal Homeowners Protection Act of 1998 (HPA) requires automatic cancellation of PMI by the lender when the LTV ratio is 78% or less of the property’s original value. Previously, this was optional on the part of the lender.

The HPA also provides the borrower with the right to request cancellation of PMI when a mortgage has been paid down to 80% of its original appraised value or purchase price, whichever is less. The borrower also has the right to accelerate the cancellation date by making additional payments that bring the LTV ratio to 80%.

PMI increases the cost of financing, as the borrower is required to pay a premium for the coverage. Although the monthly payment is higher, interest is charged only on the unpaid balance of the loan.

Obtaining a Conventional Loan

Conventional loans tend to be more difficult to obtain than an FHA or VA loan. Conventional lenders have increased their requirements for qualifying in recent years due to the high default rate in the mortgage market. Some lenders require a down payment of 20% and a credit score of 720 or above. In addition, the qualifying ratios are far more stringent than government-backed loans.
Conventional Qualifying Ratios (Debt Ratios)

- **Housing expense ratio (front-end).** The housing expense ratio (front-end) is the combined principal, interest, taxes, and insurance payment (commonly referred to as PITI) divided by the borrower’s gross monthly income. The conventional guideline is that the housing expense (front-end) ratio should not be greater than 28%.

  **Example:**

  If the borrowers PITI payment is $1,500 per month and their gross monthly income is $9,000, the housing expense ratio is 17%.

  $1,500 divided by $9,000 = 0.166 (17%)

- **Total obligations ratio (back-end).** The total obligations ratio (back-end) is the housing PITI payment and the borrower’s other monthly obligations divided by the borrower’s gross monthly income. The conventional guideline is that the total obligations ratio (back-end) should not be greater than 36%.

  **Example:**

  The borrower’s PITI payment of $1,500 plus a $1,200 car payment and an $800 credit card payment equal $3,500 total monthly obligations. This $3,500 divided by the gross monthly income of $9,000 rounds up to 39%.

  $1,500 + $1,200 + $800 = $3,500 divided by $9,000 = 0.388 (39%)

  The borrower in our example does not qualify for a conventional loan since the back-end ratio is over 36%. However, they do qualify for an FHA loan, which you’ll see when you read about FHA qualifying ratios.

Amortizing Loan Payments

If the monthly payment for a fixed, or level, payment mortgage is known, it is possible to calculate the amount of the payment that is applied to pay interest and the amount that is applied to principal. The balance of the loan that remains unpaid after the principal reduction can then be determined.

The formula for calculating the interest portion of the loan payment is:

\[ I = P \times R \times T \]

The letters in the formula represent values as follows:

- \( I \) = Interest portion amount of the monthly payment ($)
- \( P \) = Principal amount of the loan (loan balance)
- \( R \) = Rate of annual interest charged on the loan (%)  
- \( T \) = Time expressed in fractions of a year (i.e. one month is 1/12)

**Example:**

A mortgage of $100,000 for 30 years at 4% has a fixed monthly payment of $477.42. What is the balance of the loan after four monthly payments?
Solution:

Step 1
Calculate the interest amount paid. Use the formula to find the interest portion of the first monthly payment by replacing the appropriate letters in the formula with the known values and performing the arithmetic. Multiplying by 1/12 is the same as dividing by 12.

\[ I = P \times R \times T \]
\[ I = $100,000 \times 0.04 \times \frac{1}{12} \]
\[ I = $100,000 \times 0.04 \div 12 = $333.33 \] Interest for the first month

Step 2
Determine the principal amount paid. Subtract the first month's interest from the monthly payment to determine the amount of principal applied towards “paying down” the outstanding loan amount in the first month.

\[ \text{Monthly mortgage payment} - \text{Interest portion of first monthly payment} = \text{Principal portion of first monthly payment} \]
\[ $477.42 - 333.33 = 144.09 \] Principal portion of first monthly payment

Step 3
Determine the reduced loan balance. Subtract the first month’s principal payment from the principal amount originally borrowed to find the reduced balance of the loan after the first month’s payment.

\[ \text{Remaining loan balance (principal) after the first payment} \]
\[ $100,000.00 - 144.09 = 99,855.91 \]

Step 4
Repeat steps 1 through 3 for additional months. Repeat steps 1 through 4 listed above for each additional month. Use the same values for rate of interest (“R”) and time (“T”) as for the first month. However, since the remaining loan balance (principal) is reduced by each monthly payment, you must use the remaining principal balance of the loan calculated in step 3 as the new principal amount (“P”). The following table shows the results.

<table>
<thead>
<tr>
<th>Balance (New)</th>
<th>1st Month</th>
<th>2nd Month</th>
<th>3rd Month</th>
<th>4th Month</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance</td>
<td>$100,000.00</td>
<td>$99,855.91</td>
<td>$99,711.34</td>
<td>$99,566.29</td>
</tr>
<tr>
<td>Payment</td>
<td>$477.42</td>
<td>$477.42</td>
<td>$477.42</td>
<td>$477.42</td>
</tr>
<tr>
<td>Interest Portion</td>
<td>$333.33</td>
<td>$332.85</td>
<td>$332.37</td>
<td>$331.89</td>
</tr>
<tr>
<td>Principal Portion</td>
<td>$144.09</td>
<td>$144.57</td>
<td>$145.05</td>
<td>$145.53</td>
</tr>
<tr>
<td>Balance (New)</td>
<td>$99,855.91</td>
<td>$99,711.34</td>
<td>$99,566.29</td>
<td>$99,420.76</td>
</tr>
</tbody>
</table>

The example above illustrates the following characteristics of an amortized loan with a fixed monthly payment:

- The interest portion paid each month is less than the amount paid in the previous month. This is due to the slight reduction in principal balance each month; as the principal is reduced each month, the interest payment is reduced.
• The principal portion paid each month is more than the amount paid in the
previous month. Since there is a fixed monthly payment, as the interest payment
portion decreases, a larger portion of the monthly payment remains each month
to pay down the loan balance.

• The principal balance of the loan decreases each month, thereby resulting in a
zero balance at the end of the loan term.

Tools are readily available for use in calculating monthly payments, interest, and
principal amounts for amortized loans. You can use a real estate calculator or one of the
many free online amortization schedule calculators to determine the monthly payments
and totals for any given principal amount, interest rate, and loan period.

The following is an example of an amortization table that provides a comparison of
the impact of interest rate and loan term on the monthly payments and totals for an initial
loan principal amount of $100,000.

<table>
<thead>
<tr>
<th>Interest Rate %</th>
<th>15-Year Term (180 payments)</th>
<th>30-Year Term (360 payments)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Monthly Payment</td>
<td>Total Interest Paid</td>
</tr>
<tr>
<td>3.0%</td>
<td>$690.58</td>
<td>$24,304.70</td>
</tr>
<tr>
<td>3.5%</td>
<td>$714.88</td>
<td>$28,678.86</td>
</tr>
<tr>
<td>4.0%</td>
<td>$739.69</td>
<td>$33,143.83</td>
</tr>
<tr>
<td>4.5%</td>
<td>$764.99</td>
<td>$37,698.79</td>
</tr>
<tr>
<td>5.0%</td>
<td>$790.79</td>
<td>$42,342.85</td>
</tr>
<tr>
<td>5.5%</td>
<td>$817.08</td>
<td>$47,075.02</td>
</tr>
<tr>
<td>6.0%</td>
<td>$843.86</td>
<td>$51,894.23</td>
</tr>
<tr>
<td>6.5%</td>
<td>$871.11</td>
<td>$56,799.33</td>
</tr>
<tr>
<td>7.0%</td>
<td>$898.83</td>
<td>$61,789.09</td>
</tr>
<tr>
<td>7.5%</td>
<td>$927.01</td>
<td>$66,862.22</td>
</tr>
<tr>
<td>8.0%</td>
<td>$955.65</td>
<td>$72,017.38</td>
</tr>
</tbody>
</table>

### Loan Options

For a buyer who may not be able to qualify for a standard fixed-rate mortgage, other
options can put a conventional loan within their reach.

• **Biweekly mortgage.** A biweekly mortgage requires that one-half of the mortgage
payment be paid every two weeks instead of one payment per month. This is
different from a bimonthly payment. Bimonthly payments result in 24 payments
per year, whereas biweekly payments result in 26 payments per year. Therefore,
a biweekly mortgage is essentially the same as making 13 monthly payments
each year. This reduces the time necessary to amortize the loan. By making
payments every two weeks, a loan that would take 30 years to amortize in
today’s market will be paid off in approximately 25 years, thereby saving a
substantial amount of interest.

**Example:**

A 30-year mortgage for $100,000 at a rate of 4% means the homeowner
will pay approximately $71,870 in interest throughout the life of the loan.
Paying one-half of the regular monthly mortgage bi-weekly (26 payments per
year) reduces the total interest to approximately $60,593, which is a savings
of $11,277. The time to pay off the loan is reduced by 49 months, from 30
years to just under 25 years.
The disadvantage of this type of loan is that the payments are usually required to be automatically withdrawn from the borrower's checking account. Closer attention to the account balance is necessary to avoid charges for insufficient funds. Virtually the same interest savings can be achieved by making one additional monthly mortgage payment each year.

- **Graduated payment mortgage.** With a *graduated payment mortgage* (GPM), the monthly payment for principal and interest gradually increases by a certain percentage each year for a certain number of years and then levels off for the remaining term of the mortgage. This type of plan might be especially attractive to a borrower who is just starting a career and expects that their income will increase over time. This plan allows a borrower to start out with a lower monthly payment than with a traditional fixed-payment plan. The borrower can qualify for the loan based on expected salary increases along with the expectation that the value of the home will also increase over time.

  With a GPM, the borrower may have initial payments that are less than the interest-only portion of the loan at that point. The interest owed and not paid in the initial months is added back to the principal thereby causing what is referred to as a *negative amortization*.

- **Pledged account mortgage.** A *pledged account mortgage* (PAM) is a type of graduated payment mortgage under which a borrower contributes a sum of money into an account that is pledged to the lender. The account is drawn on during the first three to five years of the loan to supplement the periodic mortgage payments, thereby reducing the borrower's monthly payments in the initial years. Once the account is empty, the borrower makes the full mortgage payment.

  **Example:**

  Jim gets a PAM for a $90,000 home. He makes a down payment of $10,000, which the lender puts in a pledged account. Jim makes the payments based on a mortgage principal of $90,000, but his actual payments are reduced in the first three to five years by drawing a subsidy from the $10,000 pledged account.

- **Buydown.** A *buydown* is a variation of the PAM described above. In a buydown, the lump sum payment that is made to the lender at closing usually comes from a builder as an incentive to the buyer or from a family member who is trying to help. That payment serves to reduce the interest rate on the loan for the first few years. At the end of that time, the rate rises. The lender assumes the borrower's income will also have risen during these years and they will be able to make the increased payments.

- **Open-end loan.** An *open-end loan* is an expandable loan that gives a borrower a limit up to which they may borrow. Each incremental advance must be secured by the same mortgage and any advances may not exceed the original borrowing limit. The interest rate on the original amount borrowed is fixed. However, the interest rate on any future advances can be at the prevailing rate at the time of the advance.

  An open-end loan is usually less expensive than the conventional home improvement loan. It allows the borrower to expand the mortgage to increase the debt to the original amount. Farmers use this type of loan to meet their seasonal operating expenses. After they harvest their crops, they pay off the advance.
- **Blanket loan.** A *blanket mortgage loan* covers more than one piece of property. Land developers commonly use blanket mortgages when they buy a plot of land and divide it into many separate lots. A blanket loan usually includes a clause called a *partial release clause*. This clause allows the borrower to obtain a release of any individual lot from the lien by repaying a certain part of the loan. The lender issues the partial release for the one lot, with the provision that the mortgage will continue to cover the remaining lots.

- **Wraparound loan.** A *wraparound mortgage* allows a borrower who has an existing loan to get another loan from a second lender without paying off the first loan. The second lender issues a new larger loan to the borrower at a higher interest rate. The new loan is a combination of the first loan and the second loan. The borrower makes the new higher payments to the second lender and then the second lender pays the first lender out of those funds.

  Note: A wraparound mortgage is only possible if the original loan documents allow it.

- **Bridge loan.** A *bridge loan* is a short-term loan that covers the period between the end of one loan and the beginning of another. Bridge loans are typically used in two situations.

  o To cover the period between the end of a construction loan and the issue of a permanent loan on a property.

  o When a person needs to borrow money on his or her unsold home (a second mortgage of sorts) to fund the acquisition of a new home. This is useful when a seller will not accept a property sale contingency.

- **Purchase money mortgage.** A *purchase money mortgage (PMM)* is most commonly a technique in which the buyer borrows from the seller in addition to the lender. The purchase money mortgage is created at the time of the purchase and delivered at the time the property is transferred as part of the sale transaction. This is sometimes done when a buyer cannot qualify for a bank loan for the full amount, so the seller takes back a portion of the purchase price as a second mortgage.

- **Land contract.** A *land contract*, also called an *installment land sales contract* or a *contract for deed*, is when the buyer does not receive legal title until the final payment is made. The seller keeps legal title until the debt is paid in full. The buyer receives *equitable title* until the debt is fully paid. This type of loan is covered in more detail in the section on seller financing.

- **Construction loan.** Lenders give *construction mortgages* to finance the construction of improvements to property, such as homes, apartments, and office buildings. The lender commits to the full amount of the loan, but disburses payments over the life of the construction project. The payments are made to the general contractor or the owner for the parts of the construction that have been completed since the date of the last payment. However, before making a payment, the lender will inspect the completed work and ask the contractor to submit proof that the subcontractor has waived the lien rights for the work that the payment is covering.
Interest rates on construction loans are usually higher than on other loans because the risk is greater. The borrower pays interest on only the money that has been actually disbursed up to the payment date. These loans are short-term. The borrower can get a permanent loan, usually called a takeout loan, which pays off or takes out the lender of the construction loan, when the construction is complete. Alternatively, a borrower may be able to convert the construction loan to a permanent fixed mortgage if the lender offers that option.

- **Home equity loan.** Owners have the ability to borrow against the equity they have built up in their home. Homeowners can use a home equity loan for things, such as to purchase high dollar items, take a vacation, consolidate other loans or credit card debt, pay medical expenses, pay college tuition, or make home improvements. A *home equity loan* is an alternative to refinancing. It can be a fixed amount or a line of credit that the homeowner borrows against as needed.

- **Package mortgage.** A *package mortgage* is one that includes all the personal property and appliances that are installed on the property. This type of loan has been used extensively in the sale of furnished condominiums. The loan will include furniture, draperies, carpeting, kitchen appliances, washer and dryer, freezers, and other items as part of the purchase price for the residence.

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

- **Sale and leaseback.** The *sale and leaseback* arrangement is typically used by commercial enterprises to free up money that is tied up in the real estate to use as working capital in the business. The owner of the real estate sells the property and then leases it back from the buyer. The buyer becomes the owner and the former owner becomes the tenant. These arrangements are very complicated and should be undertaken only with proper and adequate legal and tax advice.

**GOVERNMENT LOANS**

Even though conventional loans are the most common type of loans available and most homes are financed through uninsured or insured conventional loans, the government stills play a role in providing loans for property purchases. Government-backed loans include loans that are offered by the following:

- The Federal Housing Administration (FHA)
- The Department of Veterans Affairs (DVA) (simply referred to as VA)
- Rural Housing Service (RHS)

**FHA LOANS**

The Federal Housing Administration (FHA) was established in 1934 during the Great Depression to stimulate the housing market in the United States. The FHA provides low-down-payment loans to qualified buyers.
The Department of Housing and Urban Development (HUD) oversees the FHA. The loans that the FHA provides are high LTV loans, so FHA insures the loans in order to make them available to higher risk individuals.

FHA does not build homes or loan money directly. They insure loans made by approved lending institutions, including qualified mortgage companies, savings and loan associations, and commercial banks. FHA-insured loans protect lenders against any loss they might suffer from a borrower’s default.

FHA Loan Facts

There are a number of important facts to know about FHA loans, including:

- **Type and term of the loan.** FHA loans can be either fixed-rate 10-, 15-, 20-, 25-, to 30-year loans or a 30-year fixed-period adjustable-interest rate loan.

- **Down payments.** Down payments are low. FHA requires eligible borrowers to have a FICO credit score of at least 580 and to provide a down payment of at least 3.5% of the home’s purchase price or appraised value, whichever is less. Borrowers who have a credit score between 500 and 579 are required to provide a 10% down payment. Borrowers who have a FICO score below 500 are not eligible for FHA insured financing. The down payment can be from the borrower’s own funds, from a non-repayable gift, or a combination of the two. The borrower is required to document any gift funds in a gift letter.

- **Standard loan-to-value percentages.** The standard maximum loan-to-value (LTV) ratio for an FHA insured mortgage loan is 96.5% when the borrower makes a 3.5% down payment. Closing costs associated with FHA insured mortgage loans may be rolled into the loan balance, as long as the loan-to-value maximum guidelines are still met. The loan plus closing costs must not exceed 96.5% of the home’s assessed value or the selling price, whichever is less. FHA insured mortgage loans are underwritten in $50 increments. If a mortgage calculation results in an odd amount, the loan amount will be rounded down to the next lower increment.

- **Calculating the maximum loan amount.** The maximum loan amount can be determined by multiplying the lesser of the purchase price or appraised value by the maximum LTV ratio. When closing costs are financed, these costs must be added to the purchase price. FHA insured mortgage loans are underwritten in $50 increments. If a mortgage calculation results in an odd amount, the loan amount will be rounded down to the next lower increment.

- **Loan fees.** The maximum loan fee is 1% of the loan amount and may be paid by the either the buyer or the seller.

- **FHA mortgage insurance premiums (MIP).** An FHA mortgage insurance premium (MIP) is required for all FHA insured mortgage loans, regardless of the down payment. This is not the same as private mortgage insurance (PMI) charged for conventional loans. The amount of mortgage insurance premiums required on an FHA insured mortgage loan includes the payment of both an up-front mortgage insurance premium (UFMIP) and an annual mortgage insurance premium (AMIP).
UFMIP. The *up-front mortgage insurance premium (UFMIP)* is paid at the
time of closing of the loan, even though all or a portion of the mortgage
insurance premium may be financed. The UFMIP is 1.75% of the mortgage
amount in most cases. If paid in cash at closing, the UFMIP can be paid by
the borrower, seller, or a third party.

AMIP. The standard *annual mortgage insurance premium (AMIP)* is .85% of
the annual outstanding loan balance divided into 12 monthly payments. As of
April 1, 2013, the AMIP must be paid for the life of the loan; it cannot be
cancelled. Prior to this date, the AMIP was cancelled when the loan balance
was reduced to 78% or less of the amount borrowed.

- **Default by the borrower.** FHA insured mortgage loans insure the lender 100%.
  In the event of default of the mortgage loan, the lender is reimbursed for losses
  including foreclosure costs by HUD/FHA.

- **Interest rate.** The interest rate of an FHA insured mortgage loan is determined
  by negotiation between the lender and the borrower. Interest rates are
  established by supply and demand in the marketplace.

- **Escrow account.** FHA requires that the monthly amounts the borrower pays
  toward taxes, insurance, and MIP be deposited into an escrow or impound
  account.

- **Assumption.** Loans are assumable, but the rules for assumptions vary
  depending upon when the loan originated, the type of property, and the specific
  FHA program under which the original loan was given. When an FHA insured
  mortgage loan is assumed, only the lender, not FHA, can release the original
  borrower from financial liability.

- **Appraisal.** The mortgaged real estate must be appraised by an approved FHA
  appraiser. These appraisals are called *conditional commitments* and are good for
  six months on existing property and one year on new construction.

- **Purchase price.** There is no maximum on what the purchase price of the
  property can be. The borrower can pay more than the appraisal; but the loan is
  based on the appraisal amount.

- **Standards for property type and construction.** The property must meet the
  FHA standards for type and construction. FHA also has standards about the
  quality of the neighborhood. These loans are available for one-to-four family
  residences and some condominium units.

- **Owner-occupied.** The borrower must occupy the property.

- **Pest inspection.** FHA requires evidence from a recognized structural pest
  inspection company that an existing property has no pest infestation.

- **Repair or rehabilitation of property.** FHA loans are also available to help
  residents or investors repair or rehabilitate single-family properties.
• **Prepayment.** There are no prepayment penalties on FHA loans on one-to-four-family residences. However, the borrower must give a 30-day written notice to pay a loan in full before it is due.

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

**FHA Loan Programs**

The most common loan programs are:

- **FHA Section 203(b) Mortgage Insurance.** This program provides basic mortgage insurance for the purchase or refinance of owner-occupied one-to-four family home.

- **FHA Section 203(k) Rehabilitation Mortgage Insurance.** This FHA insured mortgage loan program enables homebuyers to finance both the purchase of a one- to four-family dwelling and the cost of its rehabilitation through a single long-term fixed or adjustable rate mortgage. This program can also be used by homeowners to refinance an existing one- to four-family dwelling along with the cost of rehabilitation. However, cooperative units are not eligible for this program.

- **FHA Section 234(c) Condominiums.** This program insures a loan for 30 years specifically for the purchase of a single-unit condominium, and is similar to that for single-family detached homes.

- **FHA Section 251 Adjustable Rate Mortgages (ARM).** This program provides mortgage insurance on adjustable interest rate financing that is based on FHA/HUD approved market indexes. One-, three-, and five-year adjustable-rate mortgage (ARM) loans are available with interest rates that cannot change by more than 1% per year after the fixed-rate period, with a maximum rate increase over the life of the loan of no more than 5%. Seven- and ten-year loans are available as well. The rates for these loans cannot change more than 2% per year or more than 6% over the life of the loan.

**FHA Qualifying Ratios (Debt Ratios)**

An FHA lender looks at not only the borrower’s income but also their minimum monthly debts. The lender uses the monthly debts to calculate the debt ratios and then uses those ratios to determine the loan amount for which the borrower qualifies.

- **Housing expense ratio (front-end).** As previously discussed under Conventional Qualifying Ratios, this is the combined principle, interest, taxes, and insurance payment (PITI) divided by the borrower’s gross monthly income. The FHA guideline is that the housing expense ratio (front-end) should not be greater than 31%.

**Example:**

If the borrowers PITI payment is $1,400 per month and their gross monthly income is $7,000, the housing expense ratio is 20%.

$1,400 divided by $7,000 = 0.2 (20%)
• **Total obligations ratio (back-end).** As previously discussed under Conventional Qualifying Ratios, this is the housing PITI payment and the borrower’s other monthly obligations divided by the borrower’s gross monthly income. The FHA guideline is that the back-end should not be greater than 43%.

**Example:**

The borrower’s PITI payment of $1,400 plus a $600 car payment and a $400 credit card payment equals $2,400 total monthly obligations. This $2,400 divided by the gross monthly income of $7,000 equals 34%.

\[
\frac{1400 + 600 + 400}{7000} = 0.34 \text{ (34%)}
\]

The minimum required monthly payments of the following are included in the back-end ratios.

- **Auto loans.** Except if there are less than nine months left to pay off.
- **Student loans.** Except if there are less than nine months left to pay off.
- **Personal loans.** Except if there are less than nine months left to pay off.
- **Charge cards.** Minimum required payments only.
- **Child support.** Except if there are less than nine months left to pay off.
- **Alimony.** Except if there are less than nine months left to pay off.
- **Federal tax lien repayment schedules.** If less than nine months not calculated.

Some monthly liabilities that the FHA does not consider when calculating debt ratios include:

- **Cell phone bills**
- **Utility bills**
- **Health and car insurance**
- **Any bills that do not show on the borrower’s credit report**

**FHA Qualifying Documents**

When a borrower applies for an FHA loan, they are asked to provide information or documentation as listed below:

- Social Security number
- Home address
- Employers for the past two years
- Gross monthly income
- Bank account statements
- **All open loans**
- Personal property value
- **Any real estate owned**
- Check stubs and W-2 forms
- **Tax returns (at least two years)**

**FHA Loan Limits**

FHA sets maximum loan limits based on the county in which the property is located. As of the last published limits, maximum loan amounts in Florida range from $271,050 (for lower cost areas such as Ocala and Okeechobee) to $729,750 (for high cost areas such as Key West).
The limits for single-family homes in some of the Florida counties are shown below.

<table>
<thead>
<tr>
<th>Florida County</th>
<th>FHA Loan Limit*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broward</td>
<td>$423,750</td>
</tr>
<tr>
<td>Miami-Dade</td>
<td>$423,750</td>
</tr>
<tr>
<td>Palm Beach</td>
<td>$423,750</td>
</tr>
<tr>
<td>Martin</td>
<td>$375,000</td>
</tr>
<tr>
<td>Monroe</td>
<td>$729,750</td>
</tr>
</tbody>
</table>

* Subject to change.

For a complete list of FHA loan limits for all Florida counties, please visit the FHA Web site at www.fha.com.

VA LOANS

The VA mortgage loan program was created in 1944 to assist military veterans with financing the purchase of reasonably priced homes. The VA mortgage loan program requires little or no down payment, and provides veterans with relatively easy qualification requirements and comparatively low rates of interest.

The VA mortgage loan program guarantees permanent long-term mortgage loans that are originated by VA approved lenders for owner-occupied residences, including condominiums and mobile homes which meet VA standards. If mortgage money is not available, the VA will loan money directly to a veteran. If default occurs and a loss results from foreclosure, the borrower is responsible for the loss.

- Funding fee. Generally, all veterans who use the VA home loan benefit must pay a funding fee. This fee reduces the loan’s cost to taxpayers considering that a VA loan typically requires no down payment and has no monthly mortgage insurance. The funding fee is a percentage of the loan amount, which varies based on the type of loan and the veteran’s military category. The funding fee must be paid at closing and may be financed as long as it does not increase the loan amount beyond the maximum allowed.

- Eligibility. A veteran’s eligibility for the mortgage loan program is shown on a certificate of eligibility that is obtained from the VA. This certificate indicates the amount of guarantee for which the veteran is eligible. The VA entitlement can be used over and over again if a prior loan guaranteed by the VA is repaid, or another qualified veteran, who is willing to apply his or her entitlement to the loan balance, assumes the existing loan.

- Entitlement. The amount of the veteran’s entitlement has been changed periodically since the program’s inception in 1944. Currently it is a maximum of $106,025. A veteran must serve a specified minimum amount of time to be eligible and be honorably discharged. During peacetime, the eligibility period is 181 days, and during periods of military conflict, 90 days. Discharge in less time than required due to service-related disability automatically qualifies the veteran for benefits. Interestingly, the eligibility period was set at 90 days during the Gulf War, but congress has not re-instated the 181-day requirement. Therefore, the current eligibility period is only 90 days.

A veteran’s surviving spouse may be eligible if the veteran was killed in action or died due to service-related injuries. The spouse may also be eligible if a veteran is listed as missing-in-action or as a prisoner of war.
• **Down payment.** The VA does not require a down payment. The guarantee provided to the lender by the VA replaces the need for a down payment as it reduces the risk proportionately.

   As an example, most conventional lenders require a down payment from 20 to 25% if the loan is not insured. Assume the VA entitlement of $106,025 was equal to a 25% down payment. This would allow the borrower to obtain a loan of $424,100 ($106,025 x 4 = $424,100) with no down payment, if income is sufficient to meet the monthly debt service. Lenders may require a down payment to meet the lender’s standards, depending on the amount of the guarantee available and the income of the veteran. A minimum down payment of 5% is required for manufactured home loans.

• **Interest rate.** The interest rate is set by the lender, not the VA, and is determined by negotiation between the lender and the borrower.

• **Lender fees (points).** As with other types of loans, points are added which are paid to the lender for a VA loan. The lender, not the VA, sets the points paid. Points raise the effective rate of interest paid by the borrower over the life of a loan. Each point is equal to 1% of the loan amount and may be paid by either buyer or seller, as specified in the contract.

• **Maximum loan amount.** The VA does not set a maximum loan amount. However, the amount of the mortgage loan may not exceed the lesser of the sales price or appraised value of the property.

A veteran may use VA-guaranteed financing for any of the following situations:

- To buy a home
- To buy a townhouse or condominium unit in a project that has been approved by VA
- To build a home
- To repair, alter, or improve a home
- To simultaneously purchase and improve a home
- To improve a home through installment of a solar heating and/or cooling system or other energy efficient improvements
- To refinance an existing home loan
- To refinance an existing VA loan to reduce the interest rate and add energy efficiency improvements
- To buy a manufactured (mobile) home and/or lot
- To buy and improve a lot on which to place a manufactured home which you already own and occupy
- To refinance a manufactured home loan in order to acquire a lot

**VA Appraisals**

An approved VA appraiser must issue a *Certificate of Reasonable Value (CRV)* that is based on the appraiser’s estimate of the value of the property to be purchased. The VA loan amount may not exceed the CRV. The CRV is valid for six months on existing property and 12 months on new construction. The VA will never issue a CRV that shows the value to be greater than the sales price.
Example:

If a home is selling for $300,000 and the appraisal comes in at $325,000, the CRV will be $300,000. On the other hand, if the sales price is $300,000 and the appraisal is $275,000, the CRV will be $275,000.

The veteran may proceed with the purchase if the sales price exceeds the CRV, but they will be required to pay the difference in cash. The source of the cash must be approved by the VA. If the CRV is not equal to or greater than the sales price, the veteran may withdraw from the contract.

VA Qualifying Ratios (Debt Ratios)

The VA may be the easiest loan to qualify for in terms of ratios. The VA does not use a housing expense ratio (front-end), only a total obligations ratio (back-end) of 41%.

SELLER FINANCING

Sellers can help the buyers finance the purchase of the property. When a seller does this, it’s called seller financing.

Seller Financing Advantages

Seller financing can be complicated, but it does have its advantages.

- It can make a property more marketable, especially in times when interest rates are high or loans are hard to get. When interest rates are high, mortgage payments are also high. If the seller offers a below-market interest rate, the property is more attractive to potential buyers.
- It can help buyers who are unable to qualify for lender financing. Buyers can avoid paying some of the costs associated with lender financing, such as discount points and loan fees. Sellers may also require a lower down payment than a lender.
- Because of the potential savings, a seller might be able to get more for the property. Buyers might be willing to pay more for the home in exchange for the advantage of a low down payment, fewer closing costs, a good interest rate, and lower monthly payments.
- It may give the seller important tax benefits. Since the seller is receiving payments over a number of years, the seller needs to report only the profit received in the given year on the tax return.

Types of Seller Financing

When a seller is the only source of the buyer’s financing, it is called primary seller financing. Both the purchase money loan and the installment land sales contract (described below) are forms of primary financing. If the seller is not in a position to finance the total sale, they can offer other options to the buyer.
- **Purchase money loan.** The *purchase money loan* is when the buyers sign a promissory note that pledges to pay the seller the amount of the debt. The buyers also sign a mortgage or deed of trust that gives the sellers a security interest in the property the buyers are purchasing. The seller is actually extending credit to the buyers, allowing them to pay off the purchase price in installments over time, instead of having to pay the entire balance at closing.

- **Installment land sales contract.** As noted earlier in this chapter, with an *installment land sales contract*, also called a *contract for deed or land contract*, the buyer does not receive legal title until the final payment is made. The seller keeps legal title until the debt is paid in full. The buyer receives equitable title until the debt is fully paid.

  The buyer agrees to give the seller a down payment and to make regular payments of principal and interest for an agreed-upon number of years. The buyer also agrees to pay real estate taxes and insurance premiums and to maintain the repairs and upkeep of the property. Many installment contracts contain a provision that allows the seller to cancel the contract, keep all payments, and evict the buyer if the buyer defaults. However, many states require the seller to refund at least a part of the buyer's payments in that situation.

- **Buydown.** As mentioned earlier in this chapter, a buydown is a financing technique used to reduce the monthly payment for the buyer during the initial years of the loan. A lump sum payment is made to the lender at closing, usually by a builder as an incentive to the buyer or by a family member trying to help.

  In this case, however, the seller does not have to pay the lender a lump sum at closing. Instead, the seller agrees to have their net proceeds reduced by the amount of the buydown. It has the same effect as if the seller had agreed to reduce the purchase price of the property.

- **Closing costs.** Sellers can agree to pay some of the closing costs (within the limits lenders place on seller contributions). This allows the buyers to close the sale with less cash.

- **Lease option.** If the buyers are not ready to make the purchase, or need more time to raise down payment money or sell another home, the sellers might want to consider a lease option. A *lease option* is a clause within a lease that gives the tenants the right to purchase the property under specific conditions, usually at a predetermined price and within a set period. The owner can choose to give the tenants credit toward the purchase price for some of the rent paid, but this is not a requirement.

**TRUTH IN LENDING**

Finding the right loan can be a complicated task for buyers. They must compare the costs of the loans and look at the structure of each to see how the particular features will work for them both now and in the long term. When comparing loans, it's not enough to look at the interest rates only. The buyers must also consider the loan fees and other charges. There is a federal law in force, the *Truth in Lending Act (TILA)*, to help buyers make those comparisons.
The Truth in Lending Act, Title I of the Consumer Credit Protection Act, is implemented by Regulation Z. This law requires lenders to disclose to buyers the true cost of obtaining credit, so that borrowers can compare the costs of various lenders. Regulation Z applies to all loans that are secured by a residence. It does not apply to commercial loans or agricultural loans over $25,000.

The provisions of Regulation Z cover disclosure of costs, the right to rescind the transaction, advertising offers, and noncompliance penalties. The provisions are detailed below:

- **Disclosure.** The lender must disclose all finance charges in the annual percentage rate (APR) of the loan. The APR discloses the exact cost of credit. A total interest percentage (TIP) must also be disclosed. A TIP reflects the sum of all interest paid over the life of the loan as a percentage relative to the original loan amount.

- **Right to rescind.** In most cases, the borrower has a right to cancel the transaction by notifying the lender within three days. This does not apply to residential first mortgage loans, but does apply to refinancing and home equity loans.

- **Advertising.** Any advertising is subject to Regulation Z disclosure if it contains any of the following items, called “triggering terms”:
  - Amount or percentage of down payment
  - Installment payment or amount
  - Specific finance change
  - Number of installments
  - Period of repayment
  - Indication that there is no charge for credit

  If an ad includes any of those items, all of the following items must be disclosed.
  - The amount or percentage of down payment
  - Terms of repayment
  - Annual percentage rate and if increase is possible
  - Total finance charge
  - Total number of payments and due dates

  Regulation Z applies to advertising in ALL media, including websites, billboards, radio, TV, and direct mailings.

- **Penalties.** It is especially important that licensees do not violate the advertising requirements of Regulation Z. The penalty for violation is twice the amount of the finance charge or a minimum of $100, up to a maximum of $1,000. The violator could also be liable for court costs, attorney fees, and any actual damages. Willful violation of regulation Z is a misdemeanor that is punishable by a fine of up to $5,000 or one year in prison, or both.
THE LOAN APPLICATION PROCESS

Pre-Qualifying Your Buyer

You may want to have your buyer meet with a lender before you start looking for their new house. This will allow both you and your buyer to determine the loan amount for which they qualify. This is known as getting pre-qualified. It will save considerable time and effort by making certain you’re looking for real estate in the price range your buyer can afford.

As their real estate professional, you must impress upon your buyer the importance of this part of the process. It is the buyer’s responsibility to start the mortgage process in a timely manner as per the contract and make diligent effort to obtain the loan. These days, bad credit can be a major issue. It would be better to find out their financial position up front before you and your buyer waste a lot of time.

The Mortgage Process

Mortgage lenders are investors. They expect borrowers to pay back the amount borrowed plus interest in order to make a profit on the loan. Lenders do not want to go through a foreclosure process any more than borrowers do. To minimize the risk of foreclosure, both the borrower and the collateral must be qualified before a loan will be approved.

The application process begins when the potential borrower (applicant) contacts a lender to inquire about available loans and loan terms. A loan processor generally takes an application and passes it on to a mortgage underwriter. The mortgage underwriter reviews and verifies the information contained in the application to determine if the applicant is qualified for the loan requested. The process of risk evaluation is called mortgage underwriting.

Whether or not the applicant will obtain a mortgage loan depends upon how complete, accurate, and truthful the application is. During the mortgage underwriting process, the underwriter contacts the applicant’s current employers, past employers, and creditors in order to verify the information in the application.

When a loan is approved, the lender assumes a number of risks. The primary risk is that the borrower may default on the loan. If the borrower defaults, the lender can sue to have the mortgaged property sold at foreclosure, but there is no guarantee that the proceeds of the sale will be sufficient to cover the loan balance.

To assess the risk of default or collection problems, lenders evaluate both the applicant and the property before approving a mortgage loan.

The Loan Application

The applicant is required to provide substantial information when they submit an application for a loan.

- A purchase contract for the property in which they are interested.
- Numbers of all of their bank accounts and the address of the bank’s local branch.
• Checking account statements from the previous two or three months, plus savings account statements, if applicable.

• Tax returns for the previous two years, recent pay stubs, W-2 withholding forms, or other proof of current employment and income verification.

• Credit card bills for the past few months or canceled rent or utility checks. These will help show their payment history and the amount of revolving debt they have.

• Any information on other debt for which they get a monthly bill (car, student loans, furniture loans, or store credit cards).

• If the applicant is self-employed, they will need to provide their company's current balance sheets and recent tax returns.

• If the applicant is going to receive money from a relative or any support organization to help pay for the property, they will need to provide a gift letter. This letter explains that the money is a gift and will not need to be repaid.

The applicant is required to pay the application fee and the appraisal fee at time of application.

By ensuring that the applicant provides all of the necessary documentation at the time of application, the process will progress much faster and with fewer problems. At the end of the meeting with the lender, the applicant should have a good idea of the amount and type of loan for which they qualify. In addition, the lender should provide a good faith estimate of the amount of closing costs. After the applicant submits the completed mortgage application with all of the supporting documentation, the lender will notify them within a short period regarding whether or not they qualify.

**Qualifying the Property**

The property that serves as collateral for the loan is evaluated or appraised to determine if it is of sufficient value. The appraiser analyzes the property and issues a report, which gives an objective estimate of the property's market value. The appraiser's estimate will not necessarily be the price agreed upon between the seller and potential buyer. The underwriter is concerned with the market value of the property. Depending on what type of loan the lender wants to issue and the current LTV, the lender bases the loan amount on either the amount of the appraisal or the sales price, whichever is less.

**Qualifying the Borrower (Applicant)**

An applicant is evaluated to determine if they can repay the proposed loan. To qualify for a mortgage loan, an applicant must meet the lender's qualifications in terms of income, debt, and net worth. In addition, the applicant must demonstrate sufficient creditworthiness to be an acceptable risk.
Income

The applicant's income must be enough to cover the proposed mortgage payment and other monthly expenses. The applicant's source(s) of income must be reasonably dependable and stable. Continuous employment for at least two years in the same occupational field is generally used as criteria for loan approval. An applicant's income indicates his or her ability to make the payments that are required to repay the loan.

The applicant's stable monthly income can be derived from regular wages from a full time job, bonuses, commissions, overtime pay, part-time earnings, self-employment income, retirement income, alimony or child support, or investment income. Mortgage lenders do not accept income from temporary employment, unemployment compensation, or contributions from family members to meet the lender's standards for making a loan.

The loan officer, who performs the underwriting, verifies all of the information included on the application by actually contacting the references given. The applicant usually signs a verification form that allows the lender to collect the employment information. There is a form called Request for Verification of Employment that most lenders use. By signing this form, the applicant authorizes his or her employer to reveal confidential information about his or her job status. The information includes the applicant's wages and length of employment. The loan officer asks the employer to give an opinion of the applicant's attitude on the job, the probability of continued employment, and a prediction of what the applicant's prospects are for pay increases or promotions. Alternatively, the lender could choose to collect W-2 forms and pay stubs from the applicant and then verify the information with the employer through a phone call.

For income that does not come directly from an employer, the lender will use other verification methods.

- The lender may require copies of federal income tax returns for the previous two years to verify income from commissions or self-employment.

- Self-employed applicants may have to provide audited financial statements.

- The lender may require copies of court orders to verify alimony or child support income and copies of bank statements to show the money was received and deposited.

- Owners of rental property may have to submit copies of their ledgers for their rental properties, along with tax returns showing the income.
Debt

Once the lender has established the applicant’s monthly income, the lender will determine if that income is enough to pay a loan by establishing an income ratio and a debt ratio.

- **Income ratio.** The *income ratio* establishes the applicant’s capacity to pay by limiting the percent of gross income they may spend on housing costs. Housing costs include the principal, the interest, the taxes, and homeowner’s insurance (or the PITI), and may include some monthly assessments for mortgage insurance and utilities.

- **Debt ratio.** An applicant’s *debt ratio* is calculated based on the applicant’s monthly obligations, including those items or payments the borrower must make for other debts. These debts include car payments, revolving charge accounts, etc.

As mentioned earlier in the conventional, FHA, and VA loans sections, each loan program has its own income and debt ratio requirements.

Net Worth

The underwriter examines the assets and liabilities section of the applicant’s application very carefully. The information about the applicant’s net worth is important to the lender as it gives an indication of the applicant’s ability to keep up the payments on the loan in the event that they lose their job. This is especially important in a case where the applicant’s income is not as good quality as the lender would like. Significant net worth could make the difference in whether or not the loan is approved.

If the applicant’s net worth is predominantly cash, the lender will be very encouraged. In such a case, it becomes much more likely that the applicant has the funds needed for the down payment, closing costs, and other expenses they might encounter in the purchase of the property. Some lenders require that applicants have a reserve of cash after the purchase is complete, at least enough to cover the mortgage payments for a few months in the event of a temporary financial crisis. It raises the lender’s comfort level to know that the chances of a default during an emergency are greatly reduced with cash reserves.

An applicant’s net worth is determined simply by subtracting debts from assets.

Credit History

The underwriter obtains a report from a credit-reporting agency and reviews the applicant’s credit history. The credit report includes information about debts and repayment for the preceding seven years. Negative information such as slow repayment, collections, repossessions, foreclosures, judgments, and bankruptcies may cause the underwriter to refuse the application.

An applicant’s credit score is used to evaluate the risk associated with a loan, whether or not the lender will make the loan, and if so, to determine the rate of interest the lender will charge.

Credit scoring was introduced by the *Fair Isaac & Company (FICO)* over 30 years ago. It’s important for you to have a fundamental understanding of this very important loan-qualifying tool.
Although Fair Isaacs will not disclose the exact method used to establish a credit score, several known key points can be useful for you. This table is a breakdown of the major components that are used to develop the score and the relative weight given to each. As you can see, the payment history is the most important aspect of a credit report.

The FICO score measures the applicant's willingness to meet debt obligations and weighs heavily on the lender's decision to underwrite a loan. FICO scores can range from 300 to 850. The higher the score, the lower the risk of default by the borrower. Different types of property, such as single-family versus two- or three-family, are typically underwritten by using different score requirements.

Scores below 580 are considered poor and those above 660 are considered excellent.

<table>
<thead>
<tr>
<th>FICO Credit Score Development</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Component</strong></td>
</tr>
<tr>
<td>Payment history</td>
</tr>
<tr>
<td>Outstanding debt</td>
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<tr>
<td>Credit history</td>
</tr>
<tr>
<td>Credit report inquiries</td>
</tr>
<tr>
<td>Type of credit</td>
</tr>
</tbody>
</table>

Scores must be thought of as an indicator of risk. Applicants with scores below 580 may not automatically be denied credit; however, the interest rate will probably be higher and the type of financing available may be limited.

**MORTGAGE FRAUD**

*Mortgage fraud* is a material misstatement, misrepresentation, or omission relied upon by an underwriter or lender to fund, purchase, or insure a loan. Mortgage loan fraud is divided into two categories: fraud for property and fraud for profit.

- **Fraud for property.** *Fraud for property* and/or housing entails misrepresentation by the applicant to purchase a property for a primary residence. This scheme usually involves a single loan. Although an applicant may embellish income and conceal debt, their intent is to repay the loan.

- **Fraud for profit.** *Fraud for profit*, however, often involves multiple loans and elaborate schemes perpetrated to gain illicit proceeds from property sales. Gross misrepresentations concerning appraisals and loan documents are common in fraud for profit schemes, and participants are frequently paid for their participation.

Although there is no centralized reporting mechanism for mortgage fraud complaints or investigations, numerous regulatory, industry, and law enforcement agencies collaborate to share information used to assess the current fraud climate.

In order to protect you and your client, it is imperative that you be able to distinguish legal mortgage practices from illegal mortgage fraud.
Mortgage fraud can happen in numerous ways and be accomplished with the intentional or unintentional involvement of a real estate professional. Mortgage fraud, as described by the FBI¹, includes:

- **Property flipping.** Property flipping fraud occurs when a property is purchased, falsely appraised at a higher value, and then quickly sold. The appraisal information is fraudulent, thus making the transaction illegal.

- **Nominee loans or straw buyers.** Nominee loans (or straw buyers) fraud occurs when the identity of the applicant is concealed by using a nominee who allows the borrower to use the nominee’s name and credit history to apply for a loan.

- **Fictitious or stolen identity.** Fictitious or stolen identity fraud occurs when the applicant uses a fictitious or stolen identity on the loan application, using the true person’s name, personal identifying information, and credit history without his or her knowledge.

- **Silent second.** Silent second fraud occurs when the buyer borrows the down payment from the seller through a non-disclosed second mortgage. The primary lender believes the borrower has invested his own money in the down payment, not knowing it was borrowed from the seller. The second mortgage is usually not recorded, thereby concealing its existence from the primary lender.

- **Inflated appraisals.** Inflated appraisals occur when the appraiser is in collusion with a borrower and provides a false and inflated appraisal of the property’s value to the lender. The lender bases the loan amount on the fraudulent value.

- **Equity skimming.** Equity skimming fraud occurs when a buyer uses a stolen identity, false documents, and false credit reports to obtain a mortgage loan. Once the loan is obtained, the buyer does not make any mortgage payments; however, they collect rent payments on the property until foreclosure takes place several months later.

Other common forms of mortgage fraud include:

- **Employment fraud.** Employment fraud occurs when a borrower lies about their employment, their position at the company, or even uses a fake company name in order to justify their falsified income statement.

- **Occupancy fraud.** Occupancy fraud occurs when a borrower obtains a mortgage by claiming they will occupy the property as their primary residence, yet have no intention to occupy the property, and are purchasing it as an investment. This tactic allows the investor to obtain the property at a more favorable interest rate.

- **Shotgunning fraud.** Shotgunning fraud occurs when a borrower applies for and receives multiple loans for the same property at the same time, thereby allowing them to obtain funds well in excess of the value of the original loan.

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Foreclosure Schemes

Foreclosure schemes target people with financial problems who are at risk of losing their home. The homeowner is contacted by a person or company who claims that, for an advance up-front fee, the company can get rid of the homeowner’s debt and save their home. The person or company takes the money and disappears.

Foreclosure rescue schemes involve actually purchasing the property and leasing it back to the original homeowner. The original homeowner is told that they have the right to purchase the property back at a later date. This may or may not ever occur, or if it does, the homeowner may have to purchase it at an excessive amount or interest rate.

Another scheme involves the homeowner receiving an offer to refinance the loan to save the home from foreclosure. The homeowner signs all of the necessary documents only to find out they actually sold the home and are now facing eviction.
CHAPTER 5 REVIEW QUESTIONS

1. The ___________________________ is where borrowers and mortgage originators come together to negotiate terms and effect mortgage transactions.

2. Loan ______________________ is the process by which a borrower applies for a new loan and a lender processes that application.

3. The ___________________________ was developed to provide a constant source of funds for making real estate loans. It consists of lenders who purchase mortgage loans and assemble them into one or more loan packages for resale to other lenders or investors. Examples include ______________________, ______________________, and ______________________.

4. Lenders often charge a loan ______________________ fee to cover the cost of servicing the loan. ______________________ points, paid to the lender with a new loan, represent prepaid interest. Each point paid is _____% of the loan amount.

5. The ___________________________ is the rate of interest actually paid after lender fees are taken into account. The rule of thumb for calculating this interest rate is _____% for each point paid.

6. ______________________ refers to how the principal and interest are paid over the life of a loan repayment period. Most ______________ loans are ______________, which means the payment is sufficient to repay the interest owed and the loan principal in full over the life of the loan.

7. An ______________________ loan is a type of mortgage loan in which the borrower is only required to pay off the interest on the loan. At the end of the loan term, the borrower must be able to pay off the entire principal with a ______________ payment, or get another loan.

8. With a ______________________, the monthly payment for principal and interest gradually increases by a certain percentage each year for a certain number of years and then levels off for the remaining term of the mortgage. The borrower’s initial payments are not enough to amortize the loan, so the principal balance increases as a result of ______________________.

9. A ______________ loan is any loan that is not insured or guaranteed by the government. These loans are made by lending institutions and private lenders, usually for _____ or _____ year periods.

10. Lenders usually require ______________________ to reduce their risk when the loan amount exceeds 80% of the property value.

11. The housing expense ratio is the combined ______________, ______________, ______________, and ______________ payment (referred to as ______) divided by the borrower’s gross monthly income.

12. A ______________________ mortgage requires that ½ of the mortgage payment be paid every two weeks. This is the same as making ___ monthly payments and reduces the time needed to amortize the loan.

13. The VA may be the easiest loan to qualify for in terms of ratios. The VA does not use a front-end housing expense ratio, only a ______________________ (back-end) of _____%.

14. The process of reviewing and verifying the information on a mortgage loan application to evaluate the risk of lending the money is called mortgage ______________________.

15. When applying for a mortgage loan, the borrower is required to document any gift funds in a ____________ ________________, which explains that the money is a gift and will not need to be repaid.
CHAPTER 5 PRACTICE EXAM

1. There are three types of mortgages: conventional, FHA, and VA. Which statement accurately describes these mortgage types?
   a. Both the FHA and the VA make loans.
   b. The FHA insures loans. VA loans are guaranteed.
   c. FHA loans are guaranteed.
   d. Conventional loans are insured by the government.

2. The FICO score measures the applicant’s willingness to meet debt obligations. What does the FICO score include in its measurements?
   a. Down payment amount, loan amount, and interest rate
   b. Income, assets, and outstanding debt
   c. Payment history, outstanding debt, and credit history
   d. Income ratio, debt ratio, and loan-to-value ratio

3. Which qualifying ratio is based solely on the relationship between the monthly PITI payment and the borrower’s monthly income?
   a. Debt ratio
   b. Loan-to-value ratio
   c. Housing expense ratio
   d. Total obligations ratio

4. Which of the following is NOT a characteristic of an FHA loan?
   a. Standard LTV ratio is 96.5%
   b. UFMIP is paid at closing; AMIP is paid over the life of the loan
   c. Housing expense ratio (front-end) should not be greater than 31%
   d. Total obligations ratio (back-end) should not be less than 43%

5. The mortgage underwriter qualifies the applicant’s net worth. Why is the borrower’s net worth significant to the lender?
   a. The borrower’s net worth shows how the borrower spends their cash.
   b. The borrower’s net worth is a reflection of the borrower’s income.
   c. The borrower’s net worth indicates the ability to keep up with the loan payments if they lose their job.
   d. The borrower’s net worth is a prediction of their FICO score.

6. From whom might an individual borrower most likely obtain financing for a specific commercial property?
   a. Credit union
   b. Mortgage loan originator
   c. Pension fund
   d. Syndicate

7. Which of these entities is a shareholder-owned company that works to make sure mortgage money is available for people across the country by making sure that lenders don’t run out of mortgage funds?
   a. Freddie Mac
   b. Ginnie Mae
   c. Farmer Mac
   d. Fannie Mae

8. Which of the following is NOT generally a requirement for a VA loan?
   a. Certificate of eligibility
   b. Certificate of reasonable value (CRV) more than loan amount
   c. High down payment
   d. Funding fee

9. What is the loan-to-value ratio (LTV) for a property being purchased?
   a. The ratio of the down payment to the value of the property.
   b. The ratio of the mortgage principal to the value of the property.
   c. The ratio of the mortgage principal to the down payment.
   d. The ratio of the down payment to the mortgage principal.
10. Which of the following primary mortgage market institutions holds a major portion of the savings of the American public and is the largest source of funds for financing both apartment projects and commercial properties?
   a. Life insurance companies
   b. Credit unions
   c. Ginnie Mae
   d. Real estate investment trusts

11. Which statement does NOT accurately describe an amortized loan?
   a. Each payment applies first to the interest and then to the principal.
   b. At the beginning of the loan, the amount of each payment applied to the principal is the highest, and decreases over time.
   c. Over the life of the loan, the amount that goes toward interest in each payment decreases.
   d. The interest amount in each payment is the principal amount multiplied by the interest rate of the loan.

12. Which statement best describes property flipping fraud?
   a. When a borrower purchases a property, remolds it, and then sells it for market value.
   b. When a lender purchases a foreclosed property and sells quickly at a loss.
   c. When a borrower pays off the mortgage as soon as possible.
   d. When a borrower purchases a property, has it falsely appraised at a higher value, and then sells it quickly.

13. Steve has an existing loan with Sunray Bank and applies for a second loan. He does not have to pay off his existing mortgage in order to qualify. For which type of loan is Steve applying?
   a. Wraparound loan
   b. Home equity loan
   c. Blanket loan
   d. Graduated payment loan

14. To which of the following does Regulation Z (the Truth-in-Lending Act) apply?
   a. $35,000 farm loan
   b. $50,000 restaurant loan
   c. $75,000 condominium loan
   d. $85,000 warehouse loan

15. Which disclosure is NOT required by the Truth-in-Lending Act?
   a. Mortgage loan originator license
   b. Loan fees
   c. Annual percentage rate (APR)
   d. Points paid
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CHAPTER

WORKING WITH BUYERS

OVERVIEW

Listings produce buyers. A steady source of buyers is important, but you also need qualified buyers who are ready, willing, and able to buy. Spending time with unqualified buyers is a waste of your time. Preparation and planning is key to making sure that your first contact with a prospective buyer leaves the buyer with a good impression of you and helps you determine the motivation and intent of the buyer. Once you have qualified buyers, you need to set up plans for showing them the homes that most interest them. When your buyers find a home they want and decide to make an offer, you need to know how to walk them through the process of filling out a purchase and sale agreement and then help them to handle the seller’s response to their offer.

OBJECTIVES

After completing this chapter, you should be able to do all of the following:

- Discuss where to find and how to qualify buyers
- Describe the various aspects of working with your qualified buyers, including showing homes, overcoming objections, putting together offers, handling negotiations, and keeping a pending file
- Identify the essential elements of a contract and reasons for termination
- Describe the characteristics of an option contract
- Identify various sections of a purchase and sale agreement

BUYER PROSPECT SOURCES

The best way to succeed with buyers is to make sure that you have a steady source of qualified buyers. Several sources for finding buyers exist.

- **Listing inventory.** The very best source for obtaining buyers is your listing inventory. If you have the listings, the buyers will follow. Not only do you market your listings to other real estate professionals who have buyers, but directly to the buyers themselves. Buyers who respond to property signs, internet advertising, print advertising, or word-of-mouth may buy your listings or buy another property through you if they are qualified.

- **Sphere of influence.** Another excellent source of buyers is your sphere of influence. The consistent mailings, calls, and face-to-face contacts with your sphere is geared to remind them that you are in the real estate business, you are good at what you do, and you want their business. Working your sphere properly can generate qualified buyer prospects that are far more likely to be loyal to you.

- **Farm area.** Your farm area is an important source of buyers. If you have established a geographic farm area, consistent mailings will not only generate listings but will also produce buyer inquiries on the listings you are promoting within your farm area. In addition, you will get general buyer inquiries. Homeowners who live in your farm area have friends and relatives who might also like to live there. Because of the consistent contact from periodic mailings and prospecting, they will feel like they know you. That familiarity makes them feel more comfortable to call you instead of some other broker they don’t know.
Social media. Think of your social media network as a “Big City” that consists of various business clubs, social clubs, and unique interests that is open to everyone. Networking means you can go out, find them, and bring them back to you. It’s a good idea to connect with your market through social media and the internet. You can become the trusted adviser for those who follow you.

There are approximately 29.6 million small business owners in the country and 69% of them don’t know how to use social media effectively to acquire customers from the internet. Real estate professionals today, like other business owners, must understand and master the effective use of social media in growing their business. Traditional marketing doesn’t produce the same impact as in past. A combination of traditional, internet, and social media is required to obtain total market saturation. Building large numbers of Facebook fans, twitter followers, LinkedIn connections, and blog readers is a good place to start.

Other Sources

There are numerous other sources for qualified buyers.

Open houses. Open houses on a regular basis can be an extremely effective method of obtaining good, qualified buyers. The odds of selling a home from an open house can be somewhat small, but the chances of obtaining a qualified buyer are excellent. Most people who take the time to view an open house tend to be serious about buying. Another benefit of open houses is the potential of acquiring another listing. The surrounding neighbors may take notice of your efforts and request that you view their home for possible sale.

Referrals.

- Referrals from other brokers can be an excellent source of qualified buyers. However, this source is usually best established over an extended period by developing strong relationships with other brokers outside of your market area or area of expertise.
- Referrals from past clients are also an excellent source for qualified buyers who are already inclined to work with you.

Walk-ins. Walk-ins, or buyers you obtain by working floor duty at the brokerage office, can be an additional source.

Buyer seminars. Buyer seminars can be a source of potential buyers. However, many prospects may not be qualified.
THE CHANGING BUYER MARKET

Diversity is Good Business

With an increasing minority population, minority loan programs, and higher wages, the percentage of minority first time homebuyers increases. It is good business for licensees to develop the skills to reach the growing multicultural market of prospective homeowners.

As the U.S. Census has reported, America is more culturally diverse than at any other time in the nation’s history. This diversity is now considered to be one of the country’s greatest assets. It not only affects the way we view the world, but it affects the economy of the world. Therefore, meeting the needs of America’s diverse consumer groups has become a pragmatic strategy for business of all kinds.

In this diverse marketplace, expanding home ownership must be about opening new doors; new doors to profitability for licensees, and new doors to minority citizens and immigrants who want to own their own homes. Multicultural outreach is good for minorities hoping to own their first home. The initiative offers extraordinary benefits to licensees by substantially increasing their market share in this relatively untapped market.

The National Association of REALTORS® 2016 Profile of Home Buyers and Sellers reported the following statistics on recent homebuyers nationally:

- 25% of recent homebuyers reported themselves as a race other than Caucasian.
- 27% of first time homebuyers identified as non-white/Caucasian, whereas only 15% of repeat buyers did so.
- 7% of first time buyers, compared to 2% for repeat buyers, reported a language other than English as their primary language.
- 13% of first time homebuyers, compared to 8% for repeat buyers, reported being born outside of the United States.
Suburbs vs. Cities

Prior to 2010, historical census data indicated that minority population growth had spread to the suburbs. Reports from the Brookings Institution showed that minorities were responsible for the bulk of suburban population gains between 1990 and 2000 in 65 of the nation’s 102 metropolitan areas with populations over 500,000.

However, census data collected in 2010 - 2011 showed that there was a demographic reversal, showing that for the first time in more than nine decades, the major cities of the nation’s largest metropolitan areas grew faster than their combined suburbs. City gains and suburban downturns were evident in all parts of the country. This “back-to-the-city” movement was partially attributed to young professionals, empty nesters, retirees, and new immigrants that were drawn to the downtown life experience and activities. However, factors such as the recession, rising real estate costs, high student debt, and a challenging job market may have contributed to the lack of home purchases in the suburbs, especially for first time homebuyers.

Since 2011, statistics show that the trend may be reversing again, with the suburban populations once again growing faster than cities. Many first time millennial homebuyers are opting to purchase homes in the suburbs instead of the cities. With the rise of telecommuting, options for working remotely instead of commuting to the city are also becoming more popular.

QUALIFYING THE BUYER

Once you have your systems in place for generating buyers, you will need to qualify those buyers. In order to be successful and meet your goals, you must plan ahead and utilize your time wisely. Each day is an opportunity, and how you use that opportunity will have a direct effect on your business.

In order for you to become successful, you must work on your goal every day. You must learn to work with only qualified buyers. Working with an unqualified buyer is a huge waste of your time. Remember, your time is valuable.

Upon receiving an ad call or some other type of property or buyer inquiry, you make a determination as to how much time and effort you are going to invest in this buyer. Make your preliminary decision based on your conversation with the buyer and the answers they provides to your questions. Remember, this is just the start of qualifying, but you want to decide if the buyer is worth meeting in person. You should always give the buyer the benefit of the doubt, until you are able to determine otherwise.

Keep the person on the phone long enough to get a feel for the buyer’s motivation and for them to feel comfortable with you. Generate the feeling that you are interested in helping the buyer and that you are more than competent to accomplish the results for which the buyer is looking.

If possible, have your computer on while talking with the buyer. You will make a good impression on the caller regarding your knowledge of the market and access to the right kind of information by doing a quick search for the basic property type about which the buyer called. If you are not on your computer, or don’t have access to the information, you may have to call them back. This is not quality service.

If you can provide quality service from the first contact, you will be starting out with an advantage and will be well on your way to building buyer loyalty.
Concepts and Questions

Some concepts to follow and questions to ask include the following:

- Use your time wisely and ask for the prospect’s name and number early on in the conversation. If he or she won’t give that information, then that prospect is probably not worth pursuing.

- Ask questions and listen. You need to provide solid information, but remember, a successful salesperson listens more than they talk. You need to understand the prospect and the prospect’s needs.

- Get a general picture of what the prospect is looking for.

- What areas are of interest?

- What is the price range the prospect has in mind?

- How long has the prospect been looking?

- Is the prospect working with another real estate licensee?

- Discuss a property or two that are interesting to the prospect. Get his or her attention with something specific.

- Ask if the prospect will be paying cash or using financing. This is a good way to lead into financial qualification without making the prospect feel that you think they can’t afford it.

- Ask if the prospect has been pre-qualified. Explain that in this market, most sellers are expecting and demand a prequalification letter at the very least, and many demand a pre-approval letter. Ask if it would be possible to have your mortgage loan originator contact them. Stress that there is no obligation to use that mortgage loan originator. Be sure to explain the benefits of being pre-qualified when it comes to a home search.

It is always a good idea to briefly summarize back to the buyer the key aspects of what you heard and understood from them in the conversation. This tells the buyer that you understand their needs and provides an opportunity for the buyer to correct any misunderstandings.

At this point, if you are comfortable and feel that the prospect is worth a temporary investment of your time, set an appointment to show them one or two properties, preferably, your listings. At the showing appointment, you will be able to determine if you want to continue investing your time and effort into this buyer. You may want to ask a few more questions at the showing to help you make a decision. If you decide to take them on as a client, you can conduct a more thorough interview at your next meeting.

Some questions to use in this situation are those listed below.

- What does the buyer really need? Find out their absolute must-haves.

- What would they like? If they could have some extras or upgrades, what would they be?
What is their motivation for buying? Do they want the property to live in or as an investment?

What is their time frame?

You should be sure to record the buyer’s information in your contact management database. Include any details that were discussed or left open for your next meeting. A good habit to develop is to date the information at the time you enter it.

Protecting Your Interest with Buyers

If permitted, a buyer will use a licensee for their time, expertise, market knowledge, and of course, to play tour guide. Most licensees place little or no value on their time or expertise; in fact, when dealing with buyers most licensees do everything for FREE, with no realistic expectations of ever getting paid. They just hope that after they invest all of their time, money, and effort the buyer might actually buy a home through them; but they have nothing to hold the buyer to that. Not only do many licensees de-value their time, but also most don’t even ask for loyalty from the buyer. If you don’t value your time, how can you expect your buyer to value it?

INTERVIEWING THE BUYER

In the fast-paced world of real estate today, the buyer interview will look a little different than it did 20 or even 10 years ago. At that time, the licensees met with a buyer at their home or in the office and had a fairly, formal meeting to discuss all the details of the buyer’s real estate transaction. Today, licensees must accomplish the same results, but usually don’t have the opportunity to do it under such formal circumstances.

Today, the buyer interview is typically done during showings or in the car. This can be a very structured interview. However, if it can be done in a more casual manner and still get all the answers and make all the points, it is usually more enjoyable to the buyer and seems less invasive and time consuming.

The main objectives of the buyer interview are:

- To further qualify the buyer
- To give them an orientation of the entire process
- To get their loyalty
- To get them to commit to buying

When you speak with a prospect on the phone, you do the preliminary qualification. When you show them some properties, you have the opportunity to get a better feel for their requirements and motivations.

Start out with some casual conversation in order to build rapport with them. Then gradually transition into summarizing the information you already received on the phone, such as their wants, price range, area, timeframe, and reason for buying (motivation). Try to learn a little bit more about them and what they do.

If you like the buyer and feel that they would be worth your time and that the likelihood of them buying is high, let them know you can offer a committed, professional level of service. Tell them that you will carefully scour the market for their exact needs, will discuss the properties with them, and show them all the properties that could possibly meet their needs. In addition, tell them that you will watch the market daily for new properties and look at the For Sale by Owners as well. This is a professional form of buyer representation, and you are a true professional.
If they sound interested in what you have to offer, explain to them how the process works.

- Explain, once again, how you will watch the market for them.
- Tell them you will provide them with detailed property information that meets their needs.
- Explain how you will work with them directly to assist in narrowing down their possible choices.
- Discuss how the showing process works.
- Discuss the possibility of compromise and how it may enter into their negotiations.
- Describe the process of making an offer once they find the property that meets their needs.
- Give them a blank copy of the purchase contract for their review.
- Explain exactly how an offer is made, such as in writing, required deposits, terms, dates, and contingencies.
- Explain how the offer to purchase is handled, such as the offer, counter offer, and so on. Then explain how the acceptance and effective date works.
- Explain what will be expected of them during the pending process and prior to closing.
- Review and determine their targeted timeframes, such as when would they like to be in or close on their new property. (Based on that information, you will be able to determine when they need to be under contract, which is approximately 45 days prior to closing.)
- Ask them if they are ready to go forward and make an offer when they find exactly what they are looking for.
- It is critical for you to ask for buyer loyalty. In return for your committed service, you are asking that they be loyal to you, as well. One approach is to ask for a two to three week commitment (if you think that will be long enough) and explain that for you to be able to give them the time, effort, and focus that they need from you, they need to make all real estate inquiries through you. This means that they should not call any other licensees or For Sale by Owners during this period.

After this interview, you should know what your buyer wants and why, that they’ll be pre-qualified, they’ll be loyal, and they have an understanding of the entire process. Then set a strategy and implement it.
The Buyer’s Interview of You

It is extremely important to remember that an educated consumer will want to interview a broker before deciding to work with them. Therefore, while you are interviewing the buyer, they will also be interviewing you.

Choosing a real estate licensee can be a daunting task, considering how many licensees from which there are to choose. For the consumer, taking the time to interview a perspective licensee properly will ensure that they hire the one who is best qualified to meet their needs.

An experienced licensee should expect to be interviewed by prospective buyers and should be prepared to answer all questions in a professional manner.

It is a good idea to proactively provide this information to the buyer, even if they don’t ask. A concise and professional looking flyer or fact sheet that introduces you, provides information related to your real estate history and qualifications, and contact information is a tool for helping the buyer build confidence in you.

Questions from an Educated Buyer

- Are you a REALTOR®?
- Are you a sales associate or do you hold a broker’s license?
- Do you adhere to the REALTOR® Code of Ethics and Standards of Practice?
- How long have you been practicing real estate?
- Can you provide references from past buyers?
- How many buyers are you working with at the present time?
- How many buyer-side transactions have you closed in the last year?
- Are you full-time or part-time in real estate?
- Do you have an assistant? If so, are they full- or part-time?
- Will you handle all of my transactions? Will they be referred to an assistant or processor?
- Under what brokerage relationship will we be working? (Single Agent, Transaction Broker, or No Brokerage)
- Will you show us your own listings and, if so, under what brokerage relationship?
- How well do you know the area I am interested in?
- Will you send us property information before the actual showing?
- What distinguishes you from other brokers?
- Can you assist us in obtaining financing?
- Will you prepare a CMA for any property we may be interested in?
- Do you point out negative aspects of a property as well as positive?
- Can you assist us with selecting an inspection company, title company, or attorney?
- Will you show us foreclosed and short sale properties?
- Can you help us with a For Sale by Owner?
- Will you require a written agreement and, if so, what type?
- How will we communicate?
- How do you get paid?
BUYER STATISTICS

The National Association of REALTORS® publishes an annual “Profile of Home Buyers and Sellers” report. The following is from the NAR 2016 summary report.

Characteristics of Homebuyers

- 58% of first-time homebuyers were married couples; 71% of repeat homebuyers were married couples.

- The share of first-time homebuyers increased in 2016 to 35% of the market share, but was below the historical norm of 40% among primary residence homebuyers.

- 11% of buyers purchased a multigenerational home. The top three reasons for purchasing a multi-generational home was to take care of aging parents (19%), cost savings (18%), and children over the age of 18 moving back home (14%).

- The median age of first-time buyers increased in 2016 to 32, and decreased to age 52 for repeat buyers. The largest share of homebuyers was the 25 to 34 age group, accounting for 26% of all buyers.

- The 2016 median household income of buyers increased to $86,100. The median income was $72,000 among first-time buyers, and $98,000 among repeat buyers. Married repeat buyers have the highest income among all buyers at $107,000. Increased median household income could suggest that stricter financing and rising home prices may be forcing lower income buyers out of the market.

- For first-time homebuyers, 67% purchased for the desire to own a home of their own. Repeat homebuyers bought for the following reasons: desire for a larger home (14%), job-related relocation (11%), and the desire for a home in a better area (9%).

Characteristics of Homes Purchased

- 14% of buyers purchased new homes, with 86% purchasing previously owned homes.

- 34% of new home purchasers bought a new home to avoid renovations or problems with plumbing or electrical.

- 32% of homebuyers who bought previously owned homes purchased their home for a better price and overall value.
The typical home purchased was 1,900 square feet in size, built in 1991, and had three bedrooms and two bathrooms.

- 83% of homebuyers purchased a detached single-family home.
- 14% of recent buyers over the age of 50 bought a home in senior-related housing, either for themselves or for a friend or relative.
- When considering the purchase of a home, heating and cooling costs were at least somewhat important to 84% of buyers.

**The Home Search Process**

- For 44% of homebuyers, the first step in the home-buying process was looking online for properties, while only 17% of homebuyers first contacted a real estate agent.
- Real estate agents were viewed as a very useful information source by 79% of buyers who used an agent while searching for a home. Online web sites were seen as most useful at 86%.
- The typical homebuyer searched for 10 weeks and viewed 10 homes.
- Among buyers who used the internet during their home search, 89% of buyers found photos and 85% found detailed information about properties for sale very useful.
- 60% of recent buyers were very satisfied with their recent home buying process, up from 59% in 2015.

**Home Buying and Real Estate Professionals**

- 88% of buyers purchased their home through a real estate agent or broker; 6% purchased directly from a builder or builder’s agent.
- 42% of buyers found their agent through a referral from a friend or family member and 11% used an agent they had used before to buy or sell a home.
- Nearly 70% of recent buyers only interviewed one agent during their home search.
- 50% of buyers reported what they want most from their real estate agent is to find them the right home to purchase.
- 88% of buyers would use their agent again or recommend to others.
Financing the Home Purchase

- 88% of homebuyers financed their recent home purchase.
- Among those who financed their home purchase, buyers typically financed 90%.
- The share of first-time buyers who financed their home purchase was 96% compared to 84% of repeat buyers.
- 13% of homebuyers identified saving for a down payment as the most difficult step in the home buying process.
- Of buyers who said saving for a down payment was difficult, 49% reported that student loans made saving difficult; 40% cited credit card debt, and 34% cited car loans as also making saving difficult.
- 82% of buyers reported that they view a home purchase as a good investment.

BUYER AGREEMENTS

Showing Agreement

You may want to consider the use of a Showing Agreement to ensure loyalty from your buyer.

In the Forms Section of this book, we provide you with a copy of the Florida Association of REALTORS® (FAR) Showing Agreement (Form SA-3x Rev. 10/06).

To obtain the FAR Showing Agreement, please visit the FAR Web site: www.floridarealtors.org

By using this form, you have your buyer agree that if they purchase any of the homes you showed them, they would purchase them through you. The first time you take them to a showing, list the address of the property in Section 2 of the form and have your buyer sign the form. Then for each subsequent showing, add the address of the property in Section 2. This gives both you and your buyer a clear record of all the properties you shown them. In the event that your buyer breaks the agreement by purchasing one of he listed properties through another broker, they will still owe you the amount stated in the showing agreement. Conversely, if they purchase a property that you did not show them,
they owe you nothing. Using this agreement can be extremely effective in assuring buyer loyalty.

**Exclusive Buyer Brokerage Agreement**

To act as your buyer’s broker and receive compensation from them, it is wise to use the Exclusive Buyer Brokerage Agreement.

In the Forms Section of this book, we provide you with a copy of the Florida Association of REALTORS® Exclusive Buyer Brokerage Agreement (Form EBBA-6tn Rev. 11/16).

**SHOWING PROPERTY**

Showing property is a manner of personal style. However, one thing is for sure, your job is not to walk through the property with the buyer pointing out that, this is the kitchen, this is the bedroom, and this is the bathroom. The buyer can see that. Your job is to present the property in the very best way possible and point out all of the unique features and upgrades that make the property special.

Remember, it’s important to eliminate any objections your buyer might have. For this reason, you must pay attention to the buyer’s reactions, facial expressions, and the questions they ask. This gives you the opportunity to overcome any of their objections. However to put it simply, if they don't like a property, go on to the next one. You will not be able to talk a buyer into buying a home they don't like.

You will probably be best served by showing what the buyers consider to be the best buy or best house first. A buyer will be more motivated by the fear of losing the first house you show them than they will be by gaining the last.
When setting your appointments, keep the following in mind:

- Give the listing agent plenty of time to return your call and confirm the showing appointment.

- If a listing agent wants to meet you at the property, use the window method of scheduling. Give the listing agent a 20-minute arrival window. For instance, tell them you will arrive between 10:00 and 10:20 a.m. This will give you both some flexibility and allow for unexpected delays.

- Be punctual. Don’t get the reputation for being late.

- Do your homework. Know the properties you are showing, but let the listing agent “sell” the property to your buyer. The listing agent probably has more knowledge about the property, but you must verify the information the agent gives to your buyer.

- After the first showing, ask the buyer if the property meets their needs. If it does not, eliminate it from consideration. Repeat this process until they see a property that meets all of their needs. You can do this by asking, “If this were the only property available, would you buy it?” If they answer, “Yes,” then after the next showing, compare the two by asking, “If these were the only two properties available, which one would you buy?” By using this process of elimination, you narrow the choice to one or two properties.

- It is strongly recommended that you do not show property to large families. Some parents tend to let their children run amok. Have the children stay at home until your buyer has found the home they want. Then invite the rest of the family to see it before the purchase.

- Stay with your buyer. Don’t let them wander out of your sight. This is a possible liability issue. You don’t want someone getting injured or have a household item go missing.

- Always leave the property as you found it, unless otherwise instructed, such as doors locked, lights on or off, air-conditioning on or off, etc.

- Limit showings to a maximum of five at a time. More than five at one time usually leads to confusion and analysis paralysis.

- After each showing, when you are in your car and away from the listing agent, get your buyer’s candid opinion of the property. This will enable you to get a clearer picture of what they want.
Disclosures

When showing properties to your buyer, there are some property disclosure requirements of which you need to be aware.

- **Seller’s Real Property Disclosure Statement.** All sellers and brokers are required to disclose all material defects of the property that are not readily visible to the buyer. Presently under Florida law there is no requirement that the disclosure be in writing as long as it is complete in nature. However, if you give the disclosure verbally, it may contain inherent risk to both the seller and you by being extremely difficult to prove later in case of legal action.

  A written Seller’s Real Property Disclosure Statement is preferable for both the seller and you. Check with the listing agent to see if a written disclosure is readily available. If so, it will substantially reduce liability by making full disclosure easier to prove. A snapshot of such a disclosure is shown below.

![Seller’s Real Property Disclosure Statement]

- **Homicide, suicide, or death from natural causes.** There is no requirement to disclose murder, death, or suicide on the property. It is not considered a material defect of the property. A cause of action cannot be brought against the seller or the listing agent. Under Florida Statute 689.25, a licensee will not be subject to action for failure to disclose murder, death, or suicide in or on a property.

- **HIV or AIDS Disclosure.** You must not disclose if an occupant was infected with HIV or AIDS. It is not considered a material defect.

**Making an Offer**

When your buyer makes a selection from the properties that you have shown them, it’s time for you to encourage them to make an offer. This, however, can be a frightening concept for them.

As you work with them, be aware of their signals so you can determine if the time is right to push or to back off. It might be facial expressions or certain words that alert you to their readiness. Maybe, up until that point, your buyer’s facial expressions were closed or defensive. Gradually or suddenly, their expressions begin to soften and change into
those of eagerness or readiness. Sometimes they will ask to go back to a property again and take measuring implements or even a contractor. These are sure signs that they are ready to take action. Once you see these signals, be prepared to address objections.

Buyer Objections

The first thing to do when your buyer has objections to making the offer is to acknowledge their concerns. Don’t attempt to dismiss them; this will create an impression that you are trying to hard sell them. When your buyer has questions about what the seller will do, answer them with question about what your buyer would like to have happen.

Example: Jane, your buyer, asks, “Do you think the seller will come down on the price?” Your response could be, “What would you like to offer?”

Keep putting the ball back into their court to get them to take ownership of the offer. Actually, last minute objections are good because they are signs that the buyer is ready to submit an offer. The objections signal they need reassurance. Being ready with reasonable answers to their objections will help pave the way to drafting the offer.

Objections about Price

Most buyers are going to object to the price and will want to offer a lower price, since buyers typically believe the listing price is set at a level for built-in negotiation.

When your buyer objects to a price, ask them what they believe a fair price would be and how they arrived at that price. Most often, they will respond that they just think they should go in at a low price and negotiate up from there.

There are a couple of ways to handle your buyer’s objection to the price.

- Advise them that going in too low might put off the sellers and make them unwilling to negotiate at all. If you think the buyer’s price is so low as to be insulting, encourage them to start higher by suggesting that the comparables for recent sales indicate that the seller’s price is not out of line. Be prepared to show the buyer that by quibbling over price, they stand to lose the home they want and, in the end, the amount they save is not worth the risk of losing it.

- If your buyer is interested in a particular home and you have spent time with them reviewing its features, you will be aware of the objections they might raise.

Example: The house that your buyer is interested in has an older roof. Before they raise the objection to the price because of the roof condition, during your discussion of the offer, you could ask, “Would you like to take the roof condition into account when you make an offer?”

By using this approach, you can address your buyer’s concerns and keep them from turning the objection into a reason for not making an offer.

Overcoming the Reluctant Buyer

Buyers sometimes think there is no rush to make an offer. They think the property will wait. This may be true in a down market, but if the home is nice and in a good area, it can turn over in a matter of days after being listed.
You need to create a sense of urgency in order to get your buyer to act. You can do it with facts about how long homes in the area stay on the market, how many showings the property has had, and other facts that will point out to your buyer that the home may not be around tomorrow.

**Offer Contract**

When your buyer is ready to make an offer, spend whatever time is necessary to review the purchase offer contract in detail with them. (We discuss how to complete a Residential Purchase and Sale Contract later in this chapter.)

Make sure the buyers are involved in filling in all the blanks of the offer contract. Make sure they understand that the offer, if accepted, becomes a binding contract.

It is also important that your buyer understands that the seller probably will only negotiate a few points. Once the seller receives the offer, if they only counter on two or three points, the remainder of the offer will not be renegotiated. Consequently, your buyer should be sure that their offer reflects what they want in every way. There is an outside chance that the seller will sign the purchase agreement the first time the offer is made. The buyer must think that this will happen in order to focus on the contract’s provisions.

Your job is to help your buyer prepare an offer that the seller will seriously consider. So what do you do if your buyer wants to write an offer that is very low or one that has too many contingencies? While it is important for you to get the best price and conditions possible for your buyer, it is also important to advise them about how the seller might view their offer.

You can play a key role in giving advice to your buyer in the following areas:

- **Pricing.** You can do a CMA for the buyer to give them a good idea of the price they should offer.

- **Amount of earnest money and down payment.** You can advise the buyer regarding what may be the customary earnest money deposit for a home in their price range and let them know that the earnest money will be credited toward the down payment at closing.

- **Pre-qualification or pre-approval letter.** If the buyer can provide a pre-qualification or pre-approval letter from a mortgage loan originator, it strengthens the offer by showing the seller that they are financially qualified to obtain the financing needed to close the transaction. A pre-qualification letter can be easily and quickly obtained by calling a mortgage loan originator or lender and providing some basic financial information. A pre-approval letter involves verification of the information such as employment and source of down payment. A pre-approval letter carries more weight in a close, multiple offer situation.

- **Personal and real property issues.** When writing the offer, the buyer can indicate what personal property they want to stay and what real property they want removed.

- **Warranties.** You can advise the buyer to ask for any warranties they want the seller to provide, such as a home warranty.

- **Legal description.** You must be sure that the legal description of the property is accurate.
• **Closing date.** When advising the clients about a closing date, be sure your buyer understands how important it is to take into consideration the seller’s needs as well as their own. For example, a quick closing may be ideal for the seller if the buyer can do it. On the other hand, if the seller needs time to find another home, a later closing might be a better option if the buyer can wait.

• **Contingencies.** You should advise your buyer that the more contingencies that are attached to the contract, the less attractive it may be to the seller. Sellers expect financing or inspection contingencies, but are usually not happy if an offer is contingent on the buyer’s selling their current property. Some of these things can’t be avoided, but the buyer needs to understand the role that contingencies play in how strong an offer looks to the seller. Common contingencies include:

  o **Financing contingency.** The offer may be contingent upon the buyer obtaining specific financing from a lending institution. If a loan cannot be obtained, the buyer is not bound by the contract.

  o **Home inspection contingency.** The offer may be contingent upon a satisfactory home inspection within a specified time period; 5-10 days for example. If the home inspection is not satisfactory, the buyer may not be bound by the contract, opening up the opportunity for further negotiation of the contract terms.

• **Addenda/riders.** You should advise your buyer regarding the proper addenda and riders to attach to the offer and be sure they understand clearly what each means.

• **Final walk-through.** You should strongly advise your buyer about the importance of the final walk-through inspection of the property before closing. You should be with them when they do the walk-through and then advise them of what may need to be addressed before they sign the closing documents. We recommend that you have a copy of the sales contract with you while conducting the walk-through inspection. This way the buyer can verify that all the inclusions that were stated in the contract remain with the property and all repairs have been made. Today, it is common practice to have the buyer sign-off on the walk-through inspection to state in writing that they accept the home in its present condition. Once the buyer moves in, it will be difficult for them to say a particular item stated as an inclusion in the contract isn’t there or that a particular repair wasn’t made.

**Contracts**

Before we discuss any of the Florida-specific contracts, let’s review some general contract information with which you should already be familiar.

**Statute of Frauds [F.S. 725.01]**

The statute of frauds was first enacted in England in 1677. It was intended to provide protection against fraud in the transfer of real property. It requires any contract for the transfer of a right or interest in land to be in writing in order to be enforceable.

The statute covers real estate sales contracts, leases of more than one year, and option contracts, as well as deeds and mortgages. In order to be enforceable, all of these types of contracts must be in writing. The statute, however, does not make an oral
real estate contract invalid or illegal. Any oral contract that was executed and closed under the expressed terms of the agreement is legal.

There are three exceptions under the statute of frauds, which pertain to oral (parol) contracts, at least two of which must be in place in order to make it enforceable. They are:

- Partial payment
- Improvements to the property
- Possession of the property by the buyer

Statute of Limitations

The statute of limitations establishes time limits for the enforcement of contracts.

- Written contracts. In the case of written contracts, an action for enforcement must be brought within five years. [F.S. 95.11(2)(b)]
- Oral contracts. For oral (parol) contracts, an action for enforcement must be brought within four years. [F.S. 95.11(3)(k)]

Essential Elements of a Contract

The essentials elements of a legal contract are listed below.

- **Lawful subject.** In order for a contract to be valid, it must be for a legal purpose. Any contract for an unlawful purpose or adverse to the public welfare is not valid.
- **Agreement.** There must be agreement, also referred to as a meeting of the minds, for a contract to be created. In order to arrive at a meeting of the minds, there must be an offer and an acceptance of all terms and conditions of the offer.

  In real estate, the buyer generates the original offer and the seller receives it. The party who makes the offer is the **offeror** and the party who receives it is the **offeree.** If the party who receives the offer makes any changes to the terms and conditions of the offer, it is considered a counter offer and the original offer no longer exists. In the case of a counter offer, the offeree becomes the offeror and the offeror becomes the offeree. This back-and-forth process continues until all terms and conditions of the offer are agreed to by all parties.

  This meeting of the minds creates the contract. However, without communication the contract does not exist. For this reason, an accepted (executory) contract should be communicated back to the other party as quickly as possible.

- **Consideration.** A contract must contain **sufficient consideration.** Sufficient consideration consists of two types: valuable and good.

  Valuable consideration means anything of value including money, personal property, or a promise that can be enforced, such as a promissory note.
Good consideration, otherwise known as Love and Affection, is anything that cannot be converted to valuable consideration.

- Competent parties. All parties to the contract must be sane, sober, competent, and of age. If any party is found to be below the legal age of 18, the contract is unenforceable upon that party. In addition, if any party is found to be mentally incompetent, it could void the contract and that party could not be held accountable.

Purchase and Sale Contracts

For real estate licensees, writing a contract is one of the most important and difficult services they perform. Yet, it is often taken for granted and performed in a less than efficient manner. Working hard and investing money in your business won’t mean a thing if you can’t write a contract and get that contract to closing.

The preparation of a contract for another person is practicing law, so we cannot overstate how important it is to be proficient in the preparation of a sales contract. The responsibility and liability of preparation falls upon you. If the purchase and sale contract is prepared properly, at the time of sale, you will have fewer problems and will be far more likely to get your transaction to closing.

A preprinted contract is only viable when its provisions adequately convey the intent of the parties in any real estate transaction. If the parties have to make substantial changes to the contract to ensure that it conforms to their intent, you should suggest that the parties obtain legal counsel to prepare a custom agreement.

Forms Programs

There are numerous forms programs available through various providers. However, all REALTORS® in Florida have a state-of-the-art program, which can be accessed at www.FloridaRealtors.org.

The forms program allows you to provide clear, precise, and professionally prepared real estate forms. On very rare occasions, you may be forced to write a contract on the hood of your car, but by and large those days are long gone. Today, we prepare all of our real estate forms at the computer and send them via e-mail or fax to all of the interested parties. Not only can you prepare and send all of your real estate forms directly from the forms program, you can also store them to use later or to make revisions if necessary.

Using a forms program will ensure that you are accessing the most current, up-to-date contracts and forms.

Residential Contract for Sale and Purchase

The Residential Contract for Sale and Purchase is a critical document in real estate. It is essential for you to understand the provisions of the contract and how to complete it. If you make a mistake when filling out a sale and purchase agreement, there could be serious consequences, from losing the commission on the sale, to involvement in a lawsuit brought by one of the parties, to some sort of disciplinary action.
In the Forms Section of this book, you'll find the Residential Contract for Sale and Purchase (Realtors/FlroidaBar-5 Rev. 4/17), which is approved by the Florida REALTORS® and the Florida Bar. The instructions for completing this form are provided on the following pages.

How to Complete the Residential Contract for Sale and Purchase

Page 1

Residential Contract For Sale And Purchase
THIS FORM HAS BEEN APPROVED BY THE FLORIDA REALTORS AND THE FLORIDA BAR

PARTIES:  
1. Seller:  
2. Buyer:  

1. agree that Seller shall sell and Buyer shall buy the following described Real Property and Personal Property (collectively “Property”) pursuant to the terms and conditions of this Residential Contract For Sale And Purchase and any riders and addenda ("Contract"):

1. PROPERTY DESCRIPTION:
(a) Street address, city, zip:  
(b) Property is located in: County, Florida. Real Property Tax ID No.:  
(c) Real Property: The legal description is:  

together with all existing improvements and fixtures, including built-in appliances, built-in furnishings and attached wall-to-wall carpeting and flooring ("Real Property") unless specifically excluded in Paragraph 1(e) or by other terms of this Contract.

(d) Personal Property: Unless excluded in Paragraph 1(e) or by other terms of this Contract, the following items which are owned by Seller and existing on the Property as of the date of the initial offer are included in the purchase: range(oven), refrigerator, dishwasher, disposal, ceiling fan(s), intercom, light fixture(s), drapery rods and draperies, blinds, window treatments, smoke detector(s), garage door opener(s), security gate and other access devices, and storm shutters/panels ("Personal Property").

(e) Other Personal Property items included in this purchase are:  

Personal Property is included in the Purchase Price, has no contributory value, and shall be left for the Buyer.

The following items are excluded from the purchase:  

Line 1: Enter the complete name of the seller(s).
Line 2: Enter the complete name of the buyer(s).
Line 6: 1. Property Description:
Line 7: (a) Enter the complete street address of the property, including city, state, and zip code.
Line 8: (b) Enter the name of the county in which the property is located and the property tax ID number.
Lines 9 - 11: (c) Enter the complete legal description of the property. If you need more space for the legal description, include it on a separate page as an addendum.
Lines 15 - 19: (d) Personal Property: The items specified in Paragraph 1(d) are included in the purchase, such as the refrigerator, dishwasher, ceiling fan, blinds, etc.
Lines 20 - 21: Enter any other items that are included in the purchase.
Lines 23 - 24: (e) Enter any items that are excluded from the purchase.
2. **Purchase Price**: Enter the purchase price of the property.

3. **(a)** Enter the amount of the initial deposit to be held in escrow.

4. **Check the appropriate box to indicate whether the initial deposit check (i) accompanies the offer or (ii) is to be made within a specified number of days after the effective date.**

5. **Lines 32 - 34**: Enter the escrow agent's name and contact information.

6. **Lines 35 - 36**: If there will be an additional deposit delivered, enter the number of days after the effective date and the amount of the additional deposit.

7. **Line 38**: Enter the amount of financing. Express as either a dollar amount ($) or a percentage (%).

8. **Line 39**: Enter any other relevant information.

9. **Line 41**: Enter the closing date.

10. **Line 43**: Indicate the amount that will be paid by wire transfer or other collected funds.

11. **Line 45**: Enter the date by which the signed, executed copy of the contract must be delivered to all parties in order for the contract to remain viable.

12. **Line 50**: Enter the closing date.

13. **Bottom**: Have the buyer(s) and seller(s) initial in the spaces provided at the bottom of each page. (This is not legally required, but recommended.)
6. Occupancy and Possession:

(a) Unless the box in Paragraph 6(b) is checked, Seller shall, at Closing, deliver occupancy and possession of the Property to Buyer free of tenants, occupants and future tenancies. Also, at Closing, Seller shall have removed all personal items and trash from the Property and shall deliver all keys, garage door openers, access devices and codes, as applicable, to Buyer. If occupancy is to be delivered before Closing, Buyer assumes all risks of loss to the Property from date of occupancy, shall be responsible and liable for maintenance from that date, and shall be deemed to have accepted the Property in its existing condition as of time of taking occupancy, except with respect to any items identified by Buyer pursuant to Paragraph 12, prior to taking occupancy, which require repair, replacement, treatment or remedy.

(b) Check if Property is Subject to Lease(s) or Occupancy after Closing. If Property is subject to a lease(s) after Closing or is intended to be rented or occupied by third parties beyond Closing, the facts and terms thereof shall be disclosed in writing by Seller to Buyer and copies of the written lease(s) shall be delivered to Buyer, all within 5 days after Effective Date. If Buyer determines, in Buyer’s sole discretion, that the lease(s) or terms of occupancy are not acceptable to Buyer, Buyer may terminate this Contract by delivery of written notice of such election to Seller within 5 days after receipt of the above items from Seller, and Buyer shall be refunded the Deposit thereby releasing Buyer and Seller from all further obligations under this Contract. Estoppel Letter(s) and Seller’s affidavit shall be provided pursuant to STANDARD D. If Property is intended to be occupied by Seller after Closing, see Rider U. POST-CLOSING OCCUPANCY BY SELLER.

7. Assignability: (Check One): Buyer ☐ may assign and thereby be released from any further liability under this Contract; ☐ may assign but not be released from liability under this Contract; or ☐ may not assign this Contract.

FINANCING

8. Financing:

☐ (a) Buyer will pay cash for the purchase of the Property at Closing. There is no financing contingency to Buyer’s obligation to close. If Buyer obtains a loan for any part of the Purchase Price of the Property, Buyer acknowledges that any terms and conditions imposed by Buyer’s lender(s) or by CFPB Requirements shall not affect or extend the Buyer’s obligation to close or otherwise affect any terms or conditions of this Contract.

☐ (b) This Contract is contingent upon Buyer obtaining approval of a ☐ conventional ☐ FHA ☐ VA or ☐ other (describe loan within 30 days after Effective Date (“Loan Approval Period”) for (CHECK ONE): ☐ fixed, ☐ adjustable, ☐ fixed or adjustable rate in the Loan Amount (See Paragraph 2(c)), at an initial interest rate not to exceed ___% (if left blank, then prevailing rate based upon Buyer’s creditworthiness), and for a term of ___ years (“Financing”).

☐ (i) Buyer shall make mortgage loan application for the Financing within ___ days after Effective Date and use good faith and diligent effort to obtain approval of a loan meeting the Financing terms (“Loan Approval”) and thereafter to close this Contract; Loan Approval which requires a condition related to the sale of Buyer’s other property shall not be deemed Loan Approval for purposes of this subparagraph.

Line 61: 6. Occupancy and Possession: Review this provision with your buyers so that they understand the seller’s responsibility for removing personal items and delivering keys, garage door openers, etc. The buyer must also clearly understand their risks if they occupy the property before the closing takes place.

Line 70: (b) Check if Property is Subject to Lease(s) ... Check this box if the property is subject to lease(s) or occupancy after closing.

Lines 79-80: 7. Assignability: Check the appropriate box to indicate whether the buyer can assign the contract and be released from liability, assign the contract and still be liable, or cannot assign the contract.

Line 83: 8. Financing:

(a) Check this box if the buyer will pay cash or obtain a loan with no financing contingency.

Lines 88 - 92: (b) Check the first box if the contract is contingent on financing. Check whether the buyer is seeking a conventional, FHA, VA, or other type of loan. Complete this section with the applicable information about the loan.

Line 93: Enter the number of days within which the buyer will apply for the loan.
Line 125: (c) Check this box if the buyer is going to assume the existing mortgage.

Line 126: (d) Check this box if the buyer is seeking a purchase money note and mortgage from the seller.

Line 129: 9. Closing Costs; Title Insurance; Survey; Home Warranty; Special Assessments:

Line 130: (a) Costs to be Paid by Seller: This paragraph lists all of the costs to be paid by the seller. If the seller is to pay for something else, enter it in the “Other” line.

Line 136: (i) Enter the amount or percentage the seller will pay for general repair Items.

Line 138: (ii) Enter the amount or percentage the seller will pay for wood destroying organisms (WDO) treatment and repairs.

Line 140: (iii) Enter the amount or percentage the seller will pay for costs associated with closing out open or expired building permits.

Line 150: (b) Costs to be Paid by Buyer: This paragraph lists all of the costs to be paid by the buyer. If the buyer is to pay for something else, enter it in the “Other” line.

Line 159: (c) Title Evidence and Insurance: Enter the number of days prior to closing that the buyer will receive a title commitment. If left blank, then the buyer will receive the title commitment five days prior to closing.
Line 172: (i) Check this box if the seller is to designate the closing agent.

Line 176: (ii) Check this box if the buyer is to designate the closing agent.

Line 178: (iii) Check this box if the Miami-Dade/Broward Regional Provision applies.

Line 182: If it does, enter the amount that the seller is not obligated to pay more than.

Line 187: (e) Home Warranty: Check the appropriate box to indicate whether the buyer or the seller will pay for a home warranty, or check the N/A box if there will be no home warranty.

Line 188: If a home warranty will be provided, enter who will issue the warranty and the maximum cost.

Lines 191 - 202: (f) Special Assessments: Check box (a) on line 197 if the seller will pay installments due prior to closing. Check box (b) on line 199 if the seller will pay the assessment(s) in full prior to closing.

Lines 204 - 255 10. Disclosures: It's important to review each of the disclosure items in this paragraph so that your buyer understands which party is responsible for what actions. (Section continues on page 5 through line 255.)
Property Maintenance, Condition, Inspections and Examinations

Line 257: 11. Property Maintenance: Although you don't have to enter information in this section, be sure your buyer understands that it's the seller's responsibility to maintain the property in its existing condition as of the effective date.

Line 260: 12. Property Inspection and Repair:

Line 261: (a) Inspection Period: Enter the number of days after the effective date that the buyer has to conduct an inspection. Be sure your buyer understands that they have the right to conduct inspections of the property, but they must deliver any written reports in a timely manner or they will waive the seller's obligation to make repairs, treat, or otherwise remedy any faulty conditions.

Line 269: (b) General Property Inspection and Repair: This section is information only. You must understand the information provided regarding general inspection and property condition that you can explain it clearly to your buyer.

Page 6 Property Maintenance, Condition, Inspections, and Examinations continues on page 6 and 7 through line 368.

Page 7

Line 370: 13. Escrow Agent: This paragraph explains the responsibilities of the closing or escrow agent for collecting and disbursing the funds received in connection with the transaction. (Continues on page 8.)

Page 8

Line 390: 14. Professional Advice; Broker Liability: This paragraph stresses the importance of the parties obtaining expert advice from qualified professionals and verifying all information they receive about the property. It goes on to state a limited indemnity and hold harmless provision for the broker under certain specified circumstances. It also specifies that the broker does not reside on the property. If this is not the case and it is the broker's residence, you'll need to alter this statement. The parties also agree to pay their vendors whether or not the transaction closes.

Line 413: 15. Default: This section describes what happens if either the buyer or seller defaults. If a buyer defaults, any part of the deposit that was to be paid to the listing broker will be divided equally between the listing and cooperating brokers. However, the cooperating broker's portion cannot exceed the commission they
would have received had the sale occurred. If a seller defaults, the buyer is
entitled to the return of any deposit and may seek to recover damages or sue
for specific performance.

Line 428: **16. Dispute Resolution:** If there is a dispute over a deposit, the buyer and seller
will have ten days after the date of conflicting demands over the deposit are
made to resolve the dispute. If that fails, they will mediate pursuant to the
Florida rules for certified and court-appointed mediators with a mediator who is
certified or has real estate industry experience. The buyer and seller must
mediate all non-deposit disputes in the same manner as deposit disputes
except there is no ten-day period in which to resolve these disputes before
submitting the dispute to mediation. Litigation will resolve all disputes not
resolved by mediation.

Line 440: **17. Attorney's Fees; Costs:** The parties will split any mediator's fee, but
each will pay their own costs, expenses, and attorney's fees in mediation. In
the case of litigation, the prevailing party will be entitled to attorney's fees
paid by the non-prevailing party. (Continues on page 9.)

Page 9 **Standards for Real Estate Transactions (“Standards”)**

Line 445: **18: Standards:** What follows is a brief synopsis of the important points to
cover in this section.

Line 446: **A. Title:** This states that the title must be delivered to the buyer in the period
noted earlier in the contract and discusses the examination timeframe the
buyer has. (Section continues on page 9.)

Line 479: **B. Survey:** If the survey discloses encroachments or if items specified in
Standard A appear on the survey, the buyer must deliver written notice to the
seller in a timely manner and those items will constitute title defects. The
seller will execute at the buyer's request an affidavit of "no change" if
applicable.

Line 487: **C. Ingress and Egress:** Disclosure regarding the ingress and egress of the
property.

Line 489: **D. Lease Information:** The seller will furnish to the buyer copies of lease
information including income and expense statements for the preceding 12
months within five days after inspection period. If this differs materially from
what was represented by the seller, the buyer has five days after receipt to
terminate the contract, but no later than five days prior to closing.

Page 10 **Standards for Real Estate Transactions (“Standards”) (cont’d.)**

Line 500: **E. Liens:** The seller will give the buyer an affidavit at closing that states there
are no liens on the property and that no repairs or improvements have been
made for 90 days preceding the closing. If the property was improved or
repaired within the 90 days, the seller must provide releases and waivers of
construction liens.

Line 508: **F. Time:** All time periods will be computed in calendar days.

Line 513: **G. Force Majeure:** This paragraph allows for the delay of performance of
obligations in the event of force majeure for the time the force majeure exists.
Force majeure will include natural disasters, some manmade disasters, and
causes that are not reasonably within the control of the buyer or seller. If the
extension goes 14 days beyond closing, either party can terminate the
contract.
Line 524: **H. Conveyance:** The seller must convey a marketable title. Personal property will be transferred via a bill of sale.

Line 529: **I. Closing Location; Documents; and Procedure:** This paragraph states that closing will occur in the county in which the property is located, identifies the documents needed at closing, and states that the disbursements of proceeds and the recording of the deed are subject to the collection of funds.

Line 549: **J. Escrow Closing Procedure:** This paragraph describes the procedures that will be used if the issued title commitment does not provide for insurance against adverse matters.

Page 11 **Standards for Real Estate Transactions (“Standards”) (cont’d.)**

Line 560: **K. Prorations; Credits:** This paragraph lists all of the items that will be made current and prorated as of the date prior to the closing date and describes how the prorations will be done under certain special conditions. (Section continues on page 11.)

Line 577: **L. Access to Property to Conduct Appraisals, Inspections, and Walk-Through:** This paragraph provides that upon reasonable notice the seller will provide access to and utilities for the property for appraisals, inspections, and the walk-through.

Line 580: **M. Risk of Loss:** This paragraph describes the responsibilities of the seller regarding the cost of restoration for damage or casualty loss to the property before closing and the buyer’s options if that amount of loss exceeds 1.5% of the purchase price.

Line 590: **N. 1031 Exchange:** If either party wants to enter into a like-kind exchange, the other party will cooperate. However, the cooperating party incurs no liability or cost associated with the exchange.

Line 595: **O. Contract Not Recordable; Persons Bound; Notice; Delivery; Copies; Contract Execution:** This contract will not be recorded in any public records. The contract is binding on all parties and all notices must be in writing.

Line 604: **P. Integration; Modification:** This contract contains the full and complete understanding of all parties and no prior agreements are binding. No modifications are valid or binding unless in writing and executed by all parties.

Page 12 **Standards for Real Estate Transactions (“Standards”) (cont’d.)**

Line 609: **Q. Waiver:** Failure to comply with any specific provision of this contract does not constitute waiver of other provisions.

Line 612: **R. Riders; Addenda; Typewritten or Handwritten Provisions:** These shall control all printed provisions of the contract in conflict with them.

Line 614: **S. Collection or Collected:** This paragraph defines the terms “collection” and “collected.”

Line 618: **T. RESERVED**

Line 619: **U. Applicable Law and Venue:** Florida law applies in any interpretation of this contract and any disputes that arise will be resolved in the county in which the property is located.

Line 622: **V. FIRPTA Tax Withholding:** This section addresses foreign investment tax issues.
Addenda and Additional Terms

Line 649: 19. Addenda: Here is the list of possible items and addenda that could be included in the contract. Any attached addenda become part of the contract. Check the box next to any addenda or rider you are attaching to the contract.

Page 13 (This is the last page of the contract.)

Lines 651 - 667: 20. Additional Terms: List any additional terms that the buyer and seller wish to have as part of the contract that were not covered previously.

Line 668: Counter-Offer/Rejection

Line 669: Check this box if the seller counters the buyer’s offer.

Line 671: Check this box if the seller rejects the buyer’s offer.

Lines 680 - 681: These spaces are for the buyer’s signatures and the date they sign the contract.

Lines 682 - 683: These spaces are for the seller’s signatures and the date they sign the contract.

Lines 684 - 687: Enter the buyer’s current address on the left and the seller’s current address on the right for purposes of sending notices.

Line 688: Broker: This paragraph states that the brokers listed as the listing and cooperating brokers are the only brokers entitled to compensation in this transaction and instructs the closing agent to disburse at closing the full amount of the brokerage fees as specified in a cooperative brokerage agreement or separate brokerage agreement except for any amount already retained by the broker from the escrowed funds.

Lines 694 - 697: Enter the names of the cooperating and listing sales associate, and the cooperating and listing broker.

This completes the instructions for the Residential Contract for Sale and Purchase (Rev. 4/17).

“AS IS” Residential Contract for Sale and Purchase

```
"AS IS" Residential Contract For Sale And Purchase
This form has been approved by the Florida Realtors and the Florida Bar

1. PARTIES: that Seller shall sell and Buyer shall buy the following described Real Property and Personal Property (collectively "Property") pursuant to the terms and conditions of this "AS IS" Residential Contract For Sale And Purchase and any riders and addenda ("Contract"):  
2. PROPERTY DESCRIPTION:  
3. together with all existing improvements and fixtures, including built-in appliances, built-in furnishings and attached wall-to-wall carpeting and flooring ("Real Property") unless specifically excluded in Paragraph 1(e) or by other terms of this Contract. 
```
The “AS IS” Residential Contract for Sale and Purchase is the result of collaboration between the Florida REALTORS® and the Florida Bar Association. Due to the downturn in the real estate market in 2005, the marketplace was saturated with distressed properties, such as foreclosures and short sales. (See the Forms Section of this book for a sample of the full contract.)

Most lenders today require the use of the FAR BAR “AS IS” contract in the sale of distressed properties. It is also gaining in popularity with real estate professionals in the sale of non-distressed properties when the seller is not willing to pay for needed repairs. Use of the “AS IS” contract does not relieve the seller or the broker of the obligation to disclose any material defects that materially affect the value of the property but are not readily discernible to the buyer.

The “AS IS” contract is, essentially, the same as the standard Residential Contract for Sale and Purchase outlined previously. There are, however, some differences.

- In section 9. Closing Costs; Title Insurance; Survey; Home Warranty; Special Assessments, the language regarding the seller’s responsibilities to pay for general repair, wood destroying organisms (WDO), and costs associated with closing out open or expired building permits is not included in the “AS IS” contract.
- Section 12. Property Inspection; Right to Cancel includes language dealing with the buyer’s right to cancel that is not addressed in the standard contract. In addition, the sections in the standard contract that deal with general property inspection and wood destroying organisms (WDO) are not included in the “AS IS” contract.
- Section 12(d) Inspection and Close-Out of Building Permits from the standard contract has been rewritten and included in the “AS IS” contract under paragraph 12(c) Seller Assistance and Cooperation in Close-Out of Building Permits.
- Section 12(f) Repair Standards; Assignment of Repair and Treatment Contracts and Warranties in the standard contract was reduced substantially and appears under paragraph 12(d) Assignment of Repair and Treatment Contracts and Warranties of the “AS IS” with the language that pertains only to the assignment of repair and treatment contracts and warranties.
- Section 18(X) Buyer Waiver of Claims was added to the “AS IS” contract to address the buyer waiver of claims. In essence, this paragraph states that the buyer waives any claims against the seller (or a real estate licensee involved in the transaction) for any defects or damage that may exist at closing or is subsequently discovered.

Contract for Residential Sale and Purchase

The Contract for Residential Sale and Purchase is another type of a purchase and sale contract that is available for your use. It is very similar to the contract we outlined previously. (See the Forms Section of this book for a sample of the full contract.)
Option Contracts

An option contract is a right to buy a property during a specified period, at a specified price. It is not an obligation to buy the property, as is the case with a sales contract. It is a right that may or may not be exercised. Option contracts are, therefore, unilateral since the party acquiring the right has not promised to buy the property. To acquire this right, a party must pay a definite valuable consideration. This is true because any contract requires that both parties receive some benefit. The definite valuable consideration is given to the owner in lieu of a promise.

The right cannot be obtained without some consideration being given. The consideration paid is called option money.

Parties to an Option

The property owner who gives the right is called the optionor; the party who receives the right is called the optionee. The optionor is the only party who is obligated to do or not to do something.

Exercising an Option

The optionee has the legal right and can elect to purchase the property by exercising the option at any time within the specified option period. Once the optionee notifies the optionor of the intention to proceed with the purchase, the option contract becomes a purchase and sale contract and, therefore, becomes binding on both parties.

Requirements

Option contracts must contain all of the elements of a contract; otherwise, a court could rule that a contract does not exist.

Option contracts must meet the following requirements:

- **In writing.** Options are covered by the Statute of Frauds and must be in writing to be enforceable.

- **Price and terms.** The option must state the price and terms for the transaction.

- **Length of time.** The time period must be specified.

- **Legal description.** The contract must contain a full legal description of the property that is the subject of the option.

- **Consideration.** The optionee must pay a definite, valuable consideration, which is usually money.

Only a portion of the option money can be refunded if the option is not exercised; otherwise, a full refund would remove the consideration. An option can provide that all or a portion of the consideration paid by the optionee be applied toward the purchase price if the option is exercised. An option that is not based on a definite valuable consideration is void. [F.S. 475.43]
CONTRACT NEGOTIATION

Once you have helped your buyer to prepare an offer, it must be presented to the seller for their consideration as soon as possible. In most cases, the listing agent will actually present the offer to the seller. However, both licensees are involved in the process.

When you are the selling agent, take time to go over the entire offer with the listing agent to be sure they understand exactly what the buyer is offering.

If the buyer has some special circumstances that you think are important for the seller to know, you might want to ask to accompany them to the presentation meeting with the listing broker. If you are present at the meeting, you can answer any questions the seller may have about the buyer or the offer. If you go to the presentation meeting, you must disclose your agency status to the seller.

Once the offer is presented, you can leave the meeting, which allows time for the seller to discuss the offer with the listing broker in confidence. Once the seller decides what they want to do, it will be up to you to communicate the decision to your buyer.

Be sure your buyer understands that once the listing agent presents their offer, the seller can take one of three actions.

1. Accept the offer exactly as it is written.
2. Reject the offer totally.
3. Reject the offer and submit a counter offer to the buyer for their consideration.

Acceptance or outright rejection of an offer is easy enough to understand. A counter offer, on the other hand, requires focus and patience to deal with, both on your part as well as on the part of the buyer. It’s important for your buyer to understand that when the seller makes a counter offer, they are effectively terminating the original offer. The counter offer becomes a new offer.

Florida has a special form to use for counter offers. (An example is shown below.)

Counter offers can be written by the buyer as well as the seller. Here are some important tips to follow when helping your buyer draft a counter offer.

- Don’t exert pressure on your buyer to include something the other party wants.
- When changing important terms, rewrite the whole paragraph so it will be clear.
- Refer to the clause of the original purchase offer when appropriate.
- Don’t make changes just for the sake of change.
Be sure to date and properly attach any supplements.  
Make sure the document is signed properly.

**Contract Termination**

In the event that a contract is terminated, you should be able to explain the reason for the termination to your buyer. A contract could be terminated for any of the following reasons:

- **Breach.** If any party to a contract fails to perform as agreed, that party is in violation (or breach) of the contract. The injured party may seek legal action.

- **Revocation.** Any party to a contract who is legally entitled may terminate the contract.

- **Mutual rescission.** The parties to the contract can mutually agree to terminate the contract.

- **Lapse of time.** A contract should contain a time for performance by all parties. If time for performance is not stated, a reasonable time will be allowed. Only a court can determine what is reasonable.

- **Abandonment.** If a party to the contract does not move towards performance or completion of the contract, the other party may terminate the contract.

- **Performance.** If all parties perform as agreed under the terms of the contract and meet all obligations, the contract is terminated.

**The Pending File**

You will create a file for every one of your sales transactions. It is essential that your pending file contain all relevant documents and correspondence. You must keep the file current throughout the entire transaction. All licensees are required to maintain files for at least five years and for at least two years after the end of any litigation, whichever occurs later.

**Pending File Essentials**

The pending file must contain legible copies of all of these documents:

- Fully-executed contract
- Seller’s Real Property Disclosure Statement, if any
- Agency disclosures
- Any other applicable addenda

As the transaction progresses, you will place these other documents in the file:

- Written proof of escrow deposits
- Condominium documents receipt (if condominium contract)
- Inspection report
- Inspection contingency release
- Loan commitment
Condominium association approval (if condominium contract)
Walk-through acceptance form signed by the buyer
Closing Disclosure

You will have an abundance of email and/or fax correspondence. Keep all correspondence in order by date. For faxes that you send, write on the cover sheet exactly what you’re sending and after it’s faxed, staple the fax confirmation to the cover sheet and place it into the file. For email, print a hard copy and place it into the file. Also, document any verbal conversations.

SUCCESS WHEN WORKING WITH BUYERS

Here are some basic principles to help you succeed when working with your buyers.

- Don’t give more information than necessary.
- Learn as much about the other parties as possible.
- Understand that the party who appears to have more time (less pressure) usually has an advantage.
- Have a plan B (other choice).
- Know your buyers’ level of risk.
- Don’t represent your buyers out of a deal they want to be in.
- Personalize the buyers to other brokers.
- Present a prequalification letter.
- Discuss comps and market with your buyers.
- Discuss closing date, inspections, financing, personal property, and price (last if possible).
- Mention other choices and time to respond.
- Get agreement on as many terms as possible.
- Get a counter offer on any terms not agreed to.
- Give guidance to go forward when appropriate.

Always remember, buyers want to buy, and the sellers want to sell. Your job is to do your very best to make it happen.

“Success is the ability to go from failure to failure without losing your enthusiasm.”
~Winston Churchill
CHAPTER 6 REVIEW QUESTIONS

1. To obtain access to buyers, it is important to have a good ____________ inventory, which allows you to market to other real estate professionals in addition to buyers themselves.

2. Your ____________ of ____________, geographic ____________, and ____________ network are three key areas for finding buyers. An ____________ may not sell the home, but is a good source of qualified buyers.

3. In order to meet the requirement to disclose all material defects of the property that are not readily visible to the buyer, a written seller’s ____________ is recommended.

4. Under F.S. 689.25, it is not considered to be a material fact or defect if a property was the site of a ____________ or ____________ and therefore would need not to be disclosed to a buyer.

5. The ____________ requires any contract for the transfer of a right or interest in land to be in writing in order to be enforceable.

6. According to the ____________, the time limit for the enforcement of written contracts is _____ years and for oral contracts is _____ years.

7. A contract is not created until the offer from the ____________ is accepted by the ____________ and back to the other party.

8. All parties to a contract must be ____________. If any party is found to be below the age of ____, the contract is unenforceable upon that party.

9. The ____________ section of the Residential Contract for Sale and Purchase lists the ____________ items that are included or excluded in the purchase.

10. Although it is not legally required, it is recommended that you have the buyers and sellers ____________ the bottom of each page of the purchase agreement.

11. The purchase and sale agreement contains a ____________ clause, which allows for delay of performance of obligations in case of natural or manmade disasters not within the buyers/sellers control.

12. An ____________ contract for sale and purchase may be required in the sale of a distressed property. When using this contract, the seller or broker remain obligated to ____________.

13. An ____________ contract provides the ____________ with the right to purchase a property during a specified timeframe at a specified price from the ____________. It is a ____________ contract in that it is not an obligation to buy the property; the right may or may not be exercised. To exercise the right, definite ____________ must be paid.

14. If a party to the contract does not move forward towards performance or completion of the contract, the other party may terminate the contract due to ____________.

15. All brokers are required to maintain a pending file on every transaction for at least _____ years and for at least _____ years after the end of any litigation, whichever occurs later.
CHAPTER 6 PRACTICE EXAM

1. Which of the following is NOT one of the main objectives for conducting an initial buyer interview?
   a. Qualifying the buyer
   b. Obtain the buyer’s loyalty
   c. Obtain a signed Showing Agreement
   d. Explain the process and your services

2. Which of the following actions would NOT be advisable when assisting a buyer in the preparation of an offer?
   a. Discourage a final walk-through inspection to avoid last minute contract issues.
   b. Prepare a CMA for use in discussing price.
   c. Discuss the advantages of providing a pre-qualification or pre-approval letter.
   d. Discuss the pros and cons of attaching contingencies.

3. Working with unqualified buyers is a waste of your time. Upon an initial phone inquiry by a potential buyer, which action would NOT generally be recommended?
   a. Obtain the name and phone number early in the conversation.
   b. Schedule a face-to-face meeting immediately.
   c. Ask questions to determine the prospect’s needs and motivation.
   d. Do a quick search and suggest a specific property or two that would be interesting to the prospect.

4. Based on the NAR “2013 Profile of Home Buyers and Sellers” report, how many weeks does a typical homebuyer search before buying a home?
   a. 5
   b. 8
   c. 10
   d. 12

5. What document does a broker use when seeking a paid commission from a buyer?
   a. Broker Buyer Agreement
   b. Buyer Agent Agreement
   c. Exclusive Buyer Brokerage Agreement
   d. Broker Buyer Contract

6. What is the suggested number of properties to be shown during one appointment?
   a. 5 maximum
   b. 8 to 10
   c. 3 maximum
   d. 9

7. What should you do when showing a property to a buyer?
   a. Encourage the buyer to explore the home on their own.
   b. Be familiar with the property in advance to be able to point out any unique features or upgrades.
   c. Encourage the entire family, including any children, to participate in the showing.
   d. Avoid having the listing agent show the property to your buyer.

8. When a counter offer is made, what is the status of the original offer?
   a. The original offer is terminated.
   b. The original offer is still in force.
   c. The original offer becomes a second offer.
   d. The original offer becomes a back-up offer.

9. A potential buyer may be reluctant to make an offer. Which approach is LEAST likely to encourage a buyer to make an offer?
   a. Acknowledge the buyer’s concerns.
   b. Be prepared with reasonable answers to objections.
   c. Avoid discussing concerns unless the buyer brings them up.
   d. Instill a sense of urgency.

10. Which is NOT one of the four items that are essential for a contract to be legal?
    a. Lawful subject
    b. Witnesses
    c. Agreement (or meeting of the minds)
    d. Sufficient consideration
11. **What does “valuable consideration” refer to in a real estate transaction?**
   a. A seller’s thoughtful evaluation of each offer when presented with multiple offers
   b. Thoughtful and kind behavior on the part of the seller towards the buyer
   c. All credit and debit amounts in the closing statement
   d. Anything of value, or a promise of value that can be enforced, such as a promissory note

12. **Which reason is NOT an event that will terminate a contract?**
   a. Breach: a party to the contract fails to perform as agreed
   b. Revocation: any party who is legally entitled may terminate the contract
   c. Reconsideration: any party changes their mind about the terms of the contract
   d. Performance: all parties have performed as agreed and met all obligations

13. **Which offer would generally be the most desirable to a seller?**
   a. An offer with a pre-approval letter and no contingencies
   b. An offer with a financing contingency and no pre-qualification or pre-approval letter
   c. An offer with a contingency on the buyer selling their existing home
   d. An offer with a home inspection contingency and home warranty requirements

14. **What is stated in the Statute of Frauds?**
   a. An oral contract involved in the transfer of real estate is illegal.
   b. A contract involving the transfer of real property must be in writing to be enforceable.
   c. Actions against written contracts must be made within five years.
   d. Licensees who prepare fraudulent contracts are subject to a fine and license revocation.

15. **What is the statute of limitations on a parol contract?**
   a. 2 years
   b. 3 years
   c. 4 years
   d. 60 days
CHAPTER 7

BASIC RESIDENTIAL PRODUCT KNOWLEDGE

OVERVIEW

Real estate licensees need to have a basic understanding of the various systems and components of residential products. This product knowledge is key for the preparation of accurate property descriptions for listing profile sheets and advertising. The knowledge is also required in order to assist customers with material defect disclosures and inspection reports. If you provide inaccurate or misleading information to your buyers, they may make inappropriate and costly decisions. Therefore, it is wise for you, the real estate professional, to have a basic knowledge of the residential products you sell.

This chapter provides you with an overview of residential property components, such as lot configurations, roof types, insulation, and heating, ventilation, and air-conditioning systems (HVAC). It also provides a brief synopsis of the construction industry regulations including building codes and zoning ordinances.

OBJECTIVES

After completing this chapter, you should be able to do all of the following:

- Distinguish among different types of lots
- Describe basic substructure and superstructure elements of a building
- Distinguish among different types of roof styles, door, and window types
- Discuss insulation rating and the various types of insulation
- Describe the plumbing, HVAC, and electrical systems of a residence
- Understand how building codes regulate residential construction

INTRODUCTION

Although real estate licensees are not expected to be experts in building construction or inspection, they are expected to have a basic knowledge and understanding of the various systems and components within a home.

In the 1985, Johnson v. Davis case, the court specifically ruled that when a seller of a home knows of facts that materially affect the value of the property, are not readily observable, and are not known to the buyer, the seller has a duty to disclose them. Later court decisions affirmed that this obligation also passes to the licensee.

As a result, most licensees will have a seller sign a real property disclosure form that outlines any existing defects or problems with the property. If the form is used correctly, the licensee acts simply as an intermediary between the seller and potential buyers by supplying them with the seller’s disclosure form, but not offering any additional opinions or suggestions.

Questions often arise as to whether this form exonerates the licensee from liability. As with many questions, the answer is “yes…but...” For instance, is the licensee exonerated if they notice water stains around windows or on the ceiling that were not disclosed by the seller on the form? Is the licensee exonerated if, after discussing a particular issue with their seller, they advise the seller not to disclose it on the form? These are examples of situations where licensees may create liability for themselves by either failing to act or acting inappropriately.
In regards to home construction and home inspection, some licensees take the position that they do not want to know anything, because if they do, they create liability for themselves. While that position may apply when giving unqualified opinions, the opposite may also hold true. If a court were to look at a situation and determine that a licensee should have known there was a problem, the court could rule that the licensee acted in a negligent manner.

To avoid these types of situations, most licensees recommend to their buyers that they obtain a home inspection, with a contingency in the contract if the inspection turns up significant undisclosed problems. However, it is the buyer’s decision whether they want the inspection or not. The buyer typically pays for the inspection. It is recommended that licensees provide several home inspector recommendations to their buyers and document the fact that the recommendations were given. Keeping good records regarding this issue may help licensees later if the buyer has a problem with the property and claims that the licensee never mentioned an inspection.

The remainder of this chapter outlines various components of construction. These are intended as a very basic overview.

**LOT CONFIGURATION**

The size and shape of a site, as well as applicable zoning and building codes, has much to do with for what it can be used. A site that is either square or rectangular is less expensive to develop than one that is irregular in shape. The shape may also limit the type or design of the structure that can be placed on it. Soil conditions, drainage, and topography are also important. Any and all of these factors can affect the value of the site in the market.

There are several types of lot configurations, some of which are illustrated here.

Real estate licensees should be aware of the advantages and disadvantages of the various types of lots since they can substantially affect the value of the property. The types of lots are defined below.

- **Interior lot.** An *interior lot* is bounded on each side by another lot.

- **Corner lot.** A *corner lot* is bounded by streets on two adjacent sides. Corner lots have both advantages and disadvantages in residential neighborhoods.

  A corner lot provides more flexibility in building design as driveways can be located on the side street. More light and air reach the improvements as neighboring homes are spaced at a greater distance than is the case with interior lots.

  Since there are streets on two sides of a corner lot, two building setbacks are usually required. This requires the site to be larger than an interior lot in the same neighborhood to accommodate the double setbacks needed to obtain permission to build. An owner of a corner lot may face two paving assessments when streets need to be resurfaced or sidewalks are replaced or repaired. Other disadvantages include less privacy, greater security concerns, and potentially more traffic noise.
Cul-de-sac lot. A *cul-de-sac lot* sits at the end of a street containing a circular turnaround. Cul-de-sac lots are irregularly shaped with front yards that are generally quite small, as most of the open land area is to the rear of the lot. This type of lot offers the advantage of little street traffic and has great appeal to families with small children. Their spacious backyard areas usually provide ample room for swimming pools and other improvements. The disadvantage of this lot configuration is a lack of available parking area.

T lot. A *T lot* is located at the end of a T-intersection. A T lot may be less desirable due to car headlights shining into the home.

Flag lot. Access to the main part of a *flag lot* is over a narrow road or driveway. Improvements are located to the rear of the property.

Key lot. A *key lot* is a long, skinny lot, often bounded by a many as five or six other lots. A key lot gets its name from its resemblance to a key, with the multiple adjacent lots forming the teeth on the key.

Flag lots and key lots may not conform to current building codes, as codes frequently specify street or road frontage at minimum widths and width at the building line. If the improvements do not meet current code requirements, this fact should be brought to the attention of potential buyers.

SUBSTRUCTURE AND SUPERSTRUCTURE

Substructure

The *substructure* is located below grade and serves as a platform that supports the weight of the entire building. Soil test borings are made to determine the character of the subsoil and its ability to support the weight of the proposed building. After the boring tests have established the load-bearing capacity of the soil, a decision is made as to the type of foundation that is to serve as the substructure. Grading and clearing are then performed to ready the site for construction. The lot is staked out to show the location of the proposed improvements.

The basic foundation types are crawl space, slab, and slab-on-grade. These types are defined below.

Crawl space foundations. *Crawl space foundations* are constructed with the living area elevated above the ground, often on cement blocks. This facilitates access to plumbing and electrical service for repair and replacement of components. Air circulation under the living area also assists in cooling the home. Elevated construction limits the access of many types of pests, such as rodents and subterranean termites into the living area.

Slab foundations. *Slab foundations* may be either slab-on-grade or matt and raft. Matt and raft foundations are used on unstable soil. The foundation is made of poured concrete and reinforced with steel rods, which are placed at right angles within the cement. This type of foundation essentially floats on the top of the soil.
- **Slab-on-grade foundations.** Slab-on-grade foundations are also made of poured concrete, which is reinforced with steel rods at right angles. This is the most economical type of foundation. This type of foundation is often placed on footers, which are designed to prevent excessive settling or movement of the structure. A trench is dug around the perimeter of the construction site down to undisturbed earth, which is filled with concrete to form the footer.

Older homes in Florida made use of crawl spaces; however, slab foundations are most often selected today, with few basements. Excavation of the site is made to accommodate the type of foundation selected.

Before the concrete is poured to create the slab, utilities are brought to the site and stubbed in place. The soil is treated for termite control, a plastic vapor barrier and a mesh of steel rods is placed on the ground. Wooden forms are placed on the ground around the perimeter and concrete is poured to form the slab. The slab may be poured simultaneously with the concrete poured into the trenches to form the footers. This is called a *monolithic pour.* This method forms the slab and footers as a single unit which creates a stronger system. This process is less expensive than two separate pours. Most slab-on-grade construction utilizes a monolithic pour.

**Superstructure**

The *superstructure* is aboveground, sits atop, and is attached to, the substructure. It is the load-bearing frame or skeleton of the building. All exterior and interior walls, doors, windows, roofing, floors, and ceilings are attached to the frame, which can be constructed of masonry, wood, or a combination of materials.

- **Wood framing.** Wood framing is used in Florida to some extent. Some wood-frame homes have an exterior veneer of brick or stucco. Wood offers both advantages and disadvantages. It is a much better insulator than masonry, which results in lower heating and cooling costs. The disadvantage, particularly in southern climates, is the potential of termite infestation and decay from other types of wood-destroying organisms. Pressure-treated wood is mandatory for exterior use to limit damage from such infestation, and is required by most building codes.

  The basic types of wood frame construction are platform, balloon, and post and beam (sometimes referred to as plank and beam). These types are outlined below.

  - **Platform construction.** *Platform construction* is the most common type of wood frame construction. One story of the building is constructed at a time. studs are attached to a sill plate, which is anchored to the foundation. Studs are cut to ceiling height and secured with plates, which are placed across the top to hold the wall studs in place. If a second floor is added, additional studs are cut for the second floor and held in place by plates. Trusses are attached to the plates to form the roof structure.

  - **Balloon framing.** *Balloon framing* was originally used in colonial barns and older homes with stone or brick exteriors. Ballon framing uses a single stud, which runs from the sill to the roofline. The studs are notched at the second-floor level, and a ledger board is used to attach joists that are nailed to the studs. Although many homes were constructed by using this type of framing, it is seldom used today. The long studs cost a great deal and are labor-intensive to install. Many building codes prohibit their use, as they offer poor resistance to the spread of fire.
- **Plank and beam (post and beam) framing.** Plank and beam framing features exposed-beam ceilings. This was made popular in the 1970s and 1980s by homes featuring a great room design. Great room designs combine living, dining, and kitchen areas into one large, open space. They are commonly used in resort and vacation homes as well. From the interior of the home, the planks that form the roof are visible, as are the beams that support them. The framing members used in this type of construction are much larger and heavier than those used in other framing systems are. The ceiling beams are supported on posts, which are built into the exterior walls, often as much as eight feet apart.

- **Masonry.** Masonry is the more commonly used framing system in Florida. Exterior walls are made entirely of concrete blocks, which serve as part of the framing system. Walls are given additional strength by the use of interior steel or wood studs and metal wall ties or masonry headers, providing a stronger structure than wood framing. Hollow sections within the masonry blocks may be filled with insulating material or cement reinforced with metal rods. Exterior surfaces may be sealed and painted, or covered with a stucco finish or brick veneer. Stone is sometimes used as a decorative front.

Small cracks are common in cement block buildings. It becomes a problem when separation of the surfaces occurs. Moisture can enter the building, causing possible deterioration of wall studs, sill plates, and interior wall surfaces. Mold can form inside the walls, which can lead to foul odors and potential health hazards. In addition, of course, large cracks may indicate a serious structural or foundation problem.

Small masonry wall cracks due to settling are not usually indicative of a problem. However, large open cracks on the exterior walls should be noted. Cracks that run outward at an angle from either the top or bottom of window frames could indicate a foundation problem.

Since most of the substructure is below the surface, it is not possible to make a meaningful inspection. However, there are certain signs that may indicate a structural problem, such as cracks or bulges in concrete floors, or crumbling or cracks in the wall surfaces.

### TYPES OF ROOFS

The more common types of residential roof styles are shown in the following descriptions and photos.

- **Gable roofs** are quite common, but have one serious deficiency. In heavy winds, such as a tornado or hurricane, wind can catch the underside of the gable and lift the roof off the house. Building codes require such roofs to have substantial anchoring to prevent such occurrences.
- **Hip roofs** avoid the problem of the roof being lifted, since the gable eaves are replaced with sloping surfaces. This makes hip roofs far stronger. Many builders are opting to use hip roofs since the cost, under current building code, is less than the amount it would cost to reinforce gables.

- **Mansard roofs** are not as popular as the other roof styles. Mansard roofs are a type of hip roof where each side is double-sloped, the lower slope being much steeper than the one above it. The upper slope is not normally visible from the ground. This section of the roof is subject to a shortened life, as is the case with any flat roof. The angle of the upper slope must provide adequate drainage for the roof to have any reasonable utility.

- **Gambrel roofs** are an adaptation of the style used on barns. A gambrel roof is similar to a gable roof, except that each side is cut and raised to create four flat surfaces instead of two. In the construction of barns, raising the center of each side of the roof creates extra space for storage of hay and grain. In residential use, it allows more headroom and greater utility in the upper story.

- **Shed roofs** may be used to create an aesthetic appearance, as can be seen in the illustration, but, more often than not, are used on porches and garages to allow drainage.
• **Flat roofs** are more commonly used for detached garages, screened porches, room additions, and nonresidential buildings. Flat roofs are susceptible to wear from standing water.

  Flat roofs and built-up roofs will lose much of the gravel from the forces of wind and rain, and the asphalt will begin to show signs of cracking or bubbling. This type of roof must be repaired or replaced more frequently than other types of roofs.

• **Saltbox roofs** were used on some colonial houses. A saltbox combines a gable roof over the main living area with a shed roof over the rear portion of the house. The rear section was originally a separate room used to cure and store meat before mechanical refrigeration was invented. Salt was used in the curing process, thus the name. This construction technique survived colonial times and is still used today.

• **Dormers** are projections from the surface of a gable or hip roof which allow light and air into finished upstairs rooms and provide additional head room. Dormers may be constructed with either a gable or a shed roof and are common on Cape Cod homes.

  Roof framing must be strong enough to support itself plus the weight of the roofing and finishing materials. It must also be engineered to withstand the forces of wind and rain. Different roof styles require different types of framing. For example, tile is much heavier than shingles; therefore, the framing must be much stronger to support a tile roof.

  Roof trusses are covered with sheathing, sheathing paper, and a finishing material. All vents, chimneys, and valleys must be properly sealed with metal flashings to prevent leakage. Finishing materials include asphalt shingles, wood shakes, slate, metal, and tile. Some lower-priced properties and flat roofs have been constructed with **built-up roofs**. These are constructed by applying hot asphalt or roofing compound over the sheathing paper and topping it with fine gravel to absorb and dissipate heat.

  Roof surfaces must have sufficient slope to allow runoff of rainwater, which will assist in keeping the roof clean and extend its life. As mentioned earlier, flat roofs and decks are especially susceptible to wear from standing water. Water 3/8 inch deep over a 40’ x 60’ surface weighs 3.3 tons. Some mansard roofs have been constructed with inadequate drainage as well. Moisture condenses on roof surfaces during cooler night temperatures and heats up by the daytime sun. Roof temperatures can exceed 200 degrees during the day. This repeated warming and cooling eventually causes roofing materials to deteriorate.
Attic areas should be vented to allow air circulation. This is often accomplished by installing vented material in the soffits and gable vents or ridge vents along the peak of the roof. Air or wind-driven turbines and thermostatically controlled power vents can be used to increase circulation. Without air circulation, attics can become extremely hot, thereby increasing air-conditioning costs.

Most types of roof cover will have to be replaced several times during the life of a building. Some deterioration is usually visible over time. Asphalt shingles tend to curl at the edges when they approach the end of their life. New shingles can be placed over the existing ones without the necessity of a tear-off. However, most codes will only allow two layers without removal and replacement.

DOORS AND WINDOWS

The type of doors and windows in a home is an indicator of overall quality. Careful observation of these components can assist licensees in estimating the value of a property.

Doors

Exterior doors should be made of solid wood, metal, or glass. Heavier, most intricate doors are an indication of higher cost, and will generally not be found on homes of low-quality construction. Interior doors are most frequently hollow-core wood, although some glass is used. Older homes may be found to have solid wood doors throughout.

Hollow-core doors should not be used for exterior installation and are prohibited from such use by most building codes. The door leading from the living area to the garage should be solid, rather than hollow-core, for added fire protection.

Windows

Windows have a significant impact on the cost of heating and air-conditioning. Proper installation includes sealing around the frames to prevent air leakage. Insulated glass and multiple glazing are energy-efficiency features found in many homes today. Smaller glass areas provide greater efficiency and provide an element of security.

There are several types or styles of windows:

- **Fixed** windows do not open, as the name suggests.
- **Sliding** windows move side-to-side.
- **Single-hung** windows have only one pane of glass that is moveable.
- **Double-hung** windows have upper and lower panes, both of which may be opened or closed.
- **Awning** windows open outward from the bottom and often have a hand crank to open them.
- **Hopper** windows open outward from the top and often have a hand crank.

- **Casement** windows have two panels that open outward from the center and often have a hand crank.

- **Center pivot** windows pivot outward from a center post and may be either hand or crank operated.

- **Jalousie** windows, sometimes called *Miami windows*, have a series of small panes, which run horizontally from the top to the bottom of the window frame. The small panes operate together to open and close, using a crank. This type of window was popular before central air-conditioning became available. They are not energy-efficient and are not often used today for new construction.

### Insulation

Like quality doors and windows, the type and quality of insulating material in a home can have a dramatic effect on utility costs. Insulating material is rated according to its *R-value*. The higher the R-value, the better the insulating characteristics of the material. The R-value is a measure of the ability of the material to resist the flow of heat and is expressed in British Thermal Units (BTUs) that can be transmitted through one thickness of the material in one hour. Material with an R-value of 30 is a much better insulator than one with a value of 15. Minimum standards for wall and ceiling insulation are established by building codes.

Most insulating material is not visible since it is inside walls, ceilings, doors, and in attic spaces. Licensees should not quote the R-value of the insulating material, as it can change over the life of a building due to settling and moisture absorption. Additionally, there is no way to verify the existence or quality of the material used in areas that are not visible. Licensed professionals can be retained to perform an energy-efficiency rating, if desired.

### Types of Insulation

The different materials used to insulate a property are described below.

- **Foam** insulation is piped into wall spaces in liquid form and allowed to dry.

- **Loose-fill** is blown into wall cavities and attic spaces.

- **Rigid** insulation is used in walls in place of foam or blown-in loose-fill. It comes in sheets and is placed between the studs on the outer walls.

- **Reflective** insulation is a type of rigid insulation that has a foil facing that acts to reflect radiated heat. It is used in walls in place of foam or blown-in loose-fill. This material comes in sheets and is placed between the studs on the outer walls.

- **Flexible** insulation comes in rolls covered with Kraft paper and includes a plastic vapor barrier. This type of material is frequently used in attic areas between the joists instead of loose-fill to obtain the moisture protection afforded by the vapor barrier.
Asbestos-Containing Materials (ACMs)

Asbestos-containing materials (ACMs) have been used in the past for insulation, exterior siding, roofing shingles, and ceiling and floor tiles. Asbestos is a nonflammable mineral substance widely used in post–World War II construction and up to the 1970s. Although asbestos is a highly efficient insulator, it is a health hazard when particles become airborne (friable).

The health issue is related to the product’s degree of friability. Friability refers to how easily fibers are released into the air. ACMs do not generally become friable unless they are disturbed by breaking, cracking, crumbling, drilling, sawing, or pulverizing. Due to health hazards associated with asbestos, building codes prohibit its use in new construction.

Foam-in-Place Insulation

Foam-in-place (urea-formaldehyde) insulation was temporarily banned from use in 1982 by the Consumer Products Safety Commission. It was believed that high levels of formaldehyde released into the living space of a home, particularly right after construction, posed a health hazard. Court hearings were held, and no link could be established between the use of this product and the health of residents. This material was used in over 500,000 homes, which were built between 1970 and 1982. The ban was lifted in 1983, but publicity generated by court action and the media took its toll. As a result, the use of this material diminished.

WATER SUPPLY

Potable water suitable for drinking, cooking, and bathing is obtained either through a community water system or from an approved well. The potable water system consists of a water source, water heater, various fixtures and appliances, and possibly water-conditioning equipment. When connected to a municipal system, a water meter is installed to measure usage.

Water wells should periodically be tested for water quality. Wells that have provided good water for years can suddenly become contaminated from underground sources. Ideally, they should be equipped with a chlorinator or other filtration system.

PLUMBING SYSTEM

The plumbing system consists of hot and cold water supply lines, water and sewage disposal lines, plumbing fixtures (sinks and toilets), and hot water heaters.

Supply and Disposal Lines

Pipes that supply water and carry away waste are not visible, except under sinks. Good-quality piping may last the life of the building; however, some plastic piping has been used that is prone to splitting and breaking, which results in serious damage to the structure. Better-quality water supply lines are usually copper, with waste lines of cast iron or plastic. Plastic pipe comes in several varieties, each having certain characteristics.
**PVC.** PVC (poly vinyl chloride) pipe should never be used for hot water distribution, as it becomes soft when exposed to heat.

**CPVC.** CPVC (chlorinated poly vinyl chloride) pipe is acceptable for use with either hot or cold water.

**PB.** PB (polybutylene) pipe, which is usually colored either blue or gray, can also be used for either cold or hot water. A class action lawsuit was filed against the manufacturers of this type of pipe due to repeated claims of leakage around the joints. However, this product is still in use. Examination of the supply lines under the sinks can detect the presence of PB pipe.

**Plumbing Fixtures**

The quality of plumbing fixtures varies widely. A few examples are explained below.

- **Solid porcelain sinks** will last indefinitely.

- **Steel sinks** with an enamel finish will suffer surface flaking and rusting over time.

- **Stainless steel** is often used for kitchen sinks; however, many homeowners have become dissatisfied with stainless steel. They claim it is subject to streaking and shows fingerprints. This problem is easily solved by lightly rubbing with baby oil. Streaks will disappear and the appearance will be restored.

Faucets vary in quality and longevity as well.

**Hot Water Heaters**

*Hot water heaters* come in several varieties. Hot water tanks most commonly operate on either electricity or gas. Solar heating is occasionally used as well. Tanks come in different sizes, with most homes equipped with either a 30- or 40-gallon capacity. These tanks build up considerable internal pressure during the heating cycle. If the thermostat fails to shut off the gas flame or electric power source, tank could explode.

Tanks are protected from explosion by insertion of a temperature and pressure relief valve in or near the top of the tank. Homeowners who purchase and install their own replacement tanks may not be aware of the importance of this safety device and fail to install a new one when the tank is replaced. A new relief valve is supplied with each tank and should be installed with the tank. The existing valve should be discarded as it can become clogged with mineral deposits over long periods and fail to operate correctly.

The *tankless water heater* is a relatively new concept in heating water. It is sometimes known as an *on-demand system*. Water is heated only when needed, or on-demand, which results in savings in both energy and space, because no tank is required. The unit is mounted directly to the wall and is approximately the size of a shoebox.
HEATING, VENTILATION, AND AIR-CONDITIONING SYSTEMS (HVAC)

British Thermal Units (BTUs)

The capacity of a heating or air-conditioning (AC) system is rated in British Thermal Units (BTUs). They must be designed based on the number of cubic feet of space, typical weather conditions, and the level of insulation. Systems are commonly sized by using the term tons. One ton equals 12,000 BTUs.

Heating Systems

This section pertains to systems that only provide heating. Heating systems operate on warm or hot air, hot water, or steam. Heat may be generated from electricity, gas, or solar energy; natural heat from the subsurface of the earth may also be used. Heat is distributed by convection, radiation, or air forced through duct systems. Fuel may be gas, oil, or electricity. In northern parts of the United States, coal is frequently used.

Ducted central heat and air systems designed to both heat and cool are not very efficient. Most such systems in Florida have ductwork in the attic area to carry heated or cooled air to the living area. Since hot air tends to rise, ducts that carry heated air should be placed at a lower level; however, construction techniques used in Florida discourage such placement. Additionally, heated air has greater volume and requires larger ducts than air that has been cooled.

Types of heating systems are described below.

- **Radiation systems.** In radiation systems, air passes over the heated metal of a radiator, absorbs heat, and circulates in the area of cooler air.

- **Steam systems.** Steam systems utilize convection rather than radiation. Steam heating systems are rare in residential use in Florida, but may be encountered in older installations in the northern part of the state and in commercial facilities. A boiler heats hot water, which is distributed through pipes to metal radiators located in each room. The boiler is thermostatically controlled. Later systems use zone controls to direct heat to specified areas, rather than throughout the system.

- **In-wall gas heater.** In-wall gas heaters were often used in older Florida homes. This type of system is fueled by bottled gas. Heaters were installed on inside walls within the living area. Ducts were necessary to carry fumes from inside the home. Poor ducting could cause serious health problems and even death. This type of system predated the use of radiant or central heat systems. Some, surprisingly, are still in use.

- **Radiant ceiling heat.** Radiant ceiling heat was commonly used in the 1960s and early 1970s. A system of wires is imbedded in the plaster ceiling of each room and equipped with a separate wall thermostat. The wire acts much like a large toaster. As was mentioned earlier, hot air tends to rise. With the heat being generated from the ceiling, these systems are not very efficient. Repair of a defective system generally means tearing out the ceiling to replace the wire that serves as a heater, a costly and inconvenient task. The elements take some time to heat, so response to need is quite slow. On the plus side, they are silent and do not depend on forced airflow so use no fans to circulate heated air. Many such systems are still in use.
Another type of radiant heating system utilizes a series of copper pipes buried in the concrete slab. A boiler that is thermostatically controlled operates a circulating pump that moves heated water through the series of pipes in the floor. Boilers are usually fueled with gas. These systems are not popular due to the high cost of repair and initial expense of installation. They are, however, efficient in that heat from under the floor surface rises throughout the living space without the use of fans, providing quiet operation and an even distribution of heat. Like radiant ceiling heat, these systems tend to take a while to respond to need, as the water must first heat the cement slab before radiating into the living space.

Ventilation

The most fundamental ventilation system is, of course, windows. Fans may be used to increase airflow. Current construction methods have attempted to create more and more energy-efficient buildings. In the process, buildings now do not allow for much exchange of air between the inside of the building and the outside; therefore, air is trapped in the building. Inside air quality can diminish to the point of becoming a health hazard. Studies have indicated that indoor air may be five times more polluted than outdoor air. Carbon monoxide, carbon dioxide, formaldehyde, and other gases can accumulate in the living space unless the air is exchanged with clean, outdoor air.

Air-Conditioning Systems

This section pertains to systems that only provide cooling. Central air-conditioning systems operate by circulating liquid refrigerant, usually Freon, which is under pressure through copper tubing to an evaporator, generally located in the attic area in Florida homes. The liquid refrigerant is allowed to expand rapidly into a copper tube formed in a coiled, or serpentine, fashion. Tin fins are attached to tubing at right angles much like the radiator of an automobile. This rapid release of liquid under pressure causes the liquid to turn to a gas. This sudden expansion causes the temperature of the refrigerant to drop dramatically. By pumping the cool gas through these tubes and blowing air over them, the air temperature is reduced as the heat is removed. The cool air is blown through ducts to the living area.

The heated gas is pumped by a compressor, which is located outside of the home, through a condenser. Air is passed over the coils of the condenser by a fan, thereby removing the heat absorbed when it expands in the evaporator. Condensers also look much like an automobile radiator. The cooler gas is compressed back into a liquid and stored in a reservoir until needed for additional cooling.

Air-conditioning systems have filters installed in the air ducts to collect dust and prevent it from being pulled into the evaporator. Should a homeowner remove the filters, dust and dirt will eventually clog the fins of the evaporator and cooling will be reduced or even stopped. Dirty filters reduce airflow and add substantially to the cost of electricity needed to operate the system. Most filters must be discarded and replaced after use. Some filters are designed to be washed and reused.

Cool air resulting from operation of an air-conditioning system absorbs moisture from the air in the living space of the home. This moisture collects on the evaporator and drains to the outside of the home. This condensation can be seen running from plastic tubing near the outside unit. The drain line in the evaporator compartment can become clogged with algae. When this happens, the drain pan in the attic will overflow, thereby allowing water to come through the ceiling, causing costly repairs. Periodic technical inspection should be performed to see that the system is running correctly, the evaporator is clean, and no algae buildup is present in the drain pan. Care should be taken to see that the outside unit is not blocked by tall weeds or shrubs. Airflow can be diminished, which causes reduced efficiency or possible harm to the system.
Wall air conditioners are a self-contained system that may be mounted in a window opening or installed permanently on an exterior wall. These units are relatively inexpensive and easily installed, which led to their extensive acceptance and use.

In areas of low humidity, cooling can be accomplished by blowing air across wet excelsior or other water-absorbent material. This method is simple, inexpensive, and uses less power than conventional air conditioners. Package units that utilize this method are available for both residential and nonresidential use.

**SYSTEMS THAT PROVIDE HEATING AND COOLING**

**Heat Pumps**

A heat pump is a self-contained heating and cooling system. The cooling system operates the same as a conventional air conditioner. To create heat, the flow of the refrigerant is reversed so that heat is transferred rather than created. This is accomplished by installation of a reversing valve in the outside unit that operates off of the thermostat located in the home. When heat is called for, the reversing valve opens to reverse the Freon flow.

Heat pumps are more efficient than electric heat. A well-designed system can return as much as three times the amount of heat for each unit of electricity operating in 40-degree outside temperatures. As the temperature drops below 40 degrees, the efficiency of the system drops. However, it never drops below the one-to-one ratio typical of ordinary electric heat.

In cold temperatures while operating in the heat mode, ice will form on the outside condenser coils. The ice bank will become an insulator and the system will lose efficiency. To maintain efficiency, a defrost cycle is designed into the system. A timer operates to shut down temporarily the heating cycle and reverse the flow of refrigerant long enough to melt the ice. Vapor may be seen rising from the compressor compartment as the ice melts. It is normal to occasionally see a pool of water at the base of the outside unit, which has been created by melting ice.

One disadvantage of heat pumps is that they are slow to respond to the need for heat in extreme temperature conditions. To offset this, most systems that are manufactured today incorporate a heat strip mounted in the evaporator compartment. The heat strip operates from an emergency heat circuit. The compressor is temporarily locked out until the temperature reaches 40 degrees. Once the temperature reaches 40 degrees, the heat strip is turned off and the compressor takes over.

To determine whether a home has a heat pump, examine the wall thermostat. If it has an emergency heat setting, the system is equipped with a heat pump. Standard heating and cooling systems do not have this emergency feature.

Use caution when attempting to check the operation of a heat pump system. Rapidly turning back and forth from cooling to heating, places unusual pressure against the reversing valve and can create the need for expensive repairs.
Geothermal Systems

Geothermal systems use the temperature of the subsoil for heating and cooling and are the most efficient and least costly to operate of all heating and cooling systems. These systems do not have an outside unit like typical heat pumps. They derive their efficiency by using constant-temperature water circulated through a ground loop. The temperature below the ground remains constant year round; between about 70 and 72 degrees in Florida. This temperature well exceeds that which is needed to supply heat in the winter and low enough to provide cooling in the summer.

The unique feature of these systems is the ground loop. Several lengths of high-density polyethylene pipe (which will not rust, degrade, corrode, or disintegrate in the earth) are installed either in a horizontal loop underground or in vertical boreholes so the loop stands upright beneath the surface. The loop is filled with water and sealed. A pump circulates the water. Once the ground loop is installed, it can virtually be forgotten. Horizontal loops are less expensive to install, but require more land area.

Water is circulated through a geothermal unit inside the home. Much like typical heat pumps, geothermal units employ the flow of refrigerant through a closed loop to boost the heating and cooling capacity of the groundwater. Two heat exchangers and a condenser are used to create a hot zone for winter and a cold zone for summer cooling. Since this system is entirely within the home, there is no exposure to outside elements and extreme temperature changes; this provides an extended life for the system compared to typical heat pumps.

All heating and air-conditioning systems employ a natural law: heat always travels to cold. Since the temperature beneath the ground is a constant, warm water circulated from the home in summer will be cooled and cool water in winter will be heated.

Newer geothermal systems incorporate a specially designed hot water tank that uses water, which returns to the ground loop to assist in heating water for domestic use; in essence, it provides free hot water. This reduces the use of fuel needed to heat the water in winter months as well.

Geothermal units offer several advantages over typical heat pumps. They have a longer life expectancy and cost less to operate. There is quick response to the call for temperature change in the living area. Air coming from the ducts is either warm or cool instantly, thus overcoming one of the shortcomings of typical systems.

The disadvantage is a high initial cost of installation, which is offset within a few years by lower operating costs, resulting in a lower overall cost over the lifetime of the system compared to other HVAC systems.

ELECTRICAL SYSTEM

Electrically operated hot water tanks, refrigerators, and heating and air-conditioning systems consume the majority of the power used in the home.

Electricity is the nerve center that drives most of our modern appliances. It is a valuable tool, but has the potential to be a serious safety hazard. A basic understanding of the electrical system of a home can both inform and protect.

Electricity is the flow of electrons. It will flow through most any material, but for it to be useful, it must be directed and controlled. The use of metal wire provides a path for electricity to flow to specific places, such as appliances and electric motors. This pathway is called a conductor. One may think of a conductor as being similar to a water
Pipe. Only so much can flow through in a given period. Larger wire is used where a large quantity of electric power is required.

Attempting to force too much electricity through too small a wire causes the wire to heat, which can lead to a hazardous situation. Electric wire is rated according to wire size; the larger the number the lower the size wire. For example, a number-10 wire would be larger than a number-18 wire.

**Conductors**

Copper is the most common metal used for wiring inside the home and in most appliances. After World War II, aluminum wire came into use for house wiring due to the escalating cost of copper. However, aluminum wire in homes has been linked to fires and is prohibited by code in many parts of the country. Aluminum has an expansion/contraction rate thirty times that of copper. This expansion and contraction can cause screws that are used to attach the wire to switches and terminals to loosen, thereby causing arcing and, potentially, a fire.

Many homes may be found that still have aluminum wiring. Aluminum wire is lighter than copper, is ideal for long transmission lines, and is typically used to connect the power pole to the house.

All conductors must be insulated with material that restricts the flow of electricity. Insulating materials commonly used include rubber, plastic, and glass. Insulators prevent conductors from touching other surfaces; they direct the power to the appliance or equipment where it is needed. Insulators used in a house are color-coded for specific use. Black, red, or blue is used for the hot side of the circuit. White is used on the neutral side; green is used for a ground wire.

Most appliances and electrical outlets are polarized, which means they are designed so that the hot and neutral wires are not inadvertently reversed. Reversing these wires when connecting an outlet or appliance can potentially cause an electric shock. Polarization is accomplished by making one prong of the plug larger than the other and the outlet to match. The longer prong is the neutral that fits into the longer slot on the outlet.

**Circuits**

Electrical circuits have three components: 1) a source, 2) a path, and 3) a load. There are two types of power sources: 1) batteries, which provide direct current (DC), and 2) local power-generating stations that provide alternating current (AC). Conductors provide the path from the source to the load. The load is the device that is to work, or operate, such as a light bulb, washer, air conditioner, and so on.

In residential applications, there are generally three wires, which come into the building. Two are hot wires that deliver 120 volts; the third is a neutral. Most lights and small appliances operate on 120 volts, while hot water tanks and air conditioners operate on 240 volts. One hot wire plus the neutral is used for 120-volt applications; two hot wires plus the neutral are used for 240-volt appliances.
Electrical Terminology

- **Voltage.** Voltage (volts) is a measure of the force with which electrical energy is delivered.

- **Amperage.** Amperage (amperes or amps) refers to the flow rate of electrical current through the circuit. Most lighting circuits use 14-gauge copper wire. Higher amperage applications require heavier wire sizes.

- **Wattage.** Wattage (watts) refers to the amount of electricity being used. A 60-watt light bulb uses less electricity than a 100-watt bulb;

  \[ \text{Watts} = \text{Amps} \times \text{Volts} \]

- **Ohm.** Ohm is a measure of the resistance of a load, such as a motor, to the flow of electrons. All loads tend to restrict the flow of electrons through the circuit; the greater the resistance, the more heat that may be generated.

Circuit Protection

Heat generated by electricity, which is flowing through the conductors, can reach dangerous levels if overloaded. Electric service panel boxes contain either fuses or circuit breakers that are heat-sensitive so they will break the circuit before the temperature can reach above safe levels. Older systems used fuses that contained a heat strip designed to melt at a certain temperature, thereby interrupting the flow of electricity. Modern systems use circuit breakers that trip to the off position when overheating occurs. Fuses must be replaced if the heat strip melts, but circuit breakers can be reset and continued in use.

A main fuse or circuit breaker located in the panel box limits the total amperage within the home. Older homes had total service of no more than 60 to 100 amperes. These systems are inadequate in today’s world. Most homes are now equipped with 200 amperes or more, depending on size and equipment requirements. Typical household circuits are limited to 15 amperes; appliance circuits may be limited to 20 or 30 amperes. Fuses or circuit breakers should never be replaced with one of greater amperage rating.

Areas of a house that present a greater risk of electrical shock require ground fault interrupters (GFIs). These are typically found outside and in kitchens and baths.

REGULATION OF THE CONSTRUCTION INDUSTRY

Federal, state, and local building codes provide a set of rules that specify minimum standards for buildings and structures. The purpose of building codes is to protect the public health, safety, and general welfare as they relate to the construction and occupancy of buildings and structures. The building code becomes law of a particular jurisdiction when it is formally enacted by the appropriate authority.

Building codes are generally applied by architects, engineers, and construction contractors, but are also used by others, including inspectors, real estate developers, and insurance companies.
Federal Regulation

The federal government imposes certain building code requirements on all states that they must follow in order to receive revenue-sharing funds. This money is important to the states for maintaining highways, schools, and other public works. A model building code has been adopted by the federal government and modified with regional codes designed to meet geographical need.

The southeastern United States is governed by the *Southern Building Code*, which regulates the construction of all buildings in Florida. The Southern Building Code has been modified several times in response to changing technology and weather-related disasters. The most recent change was made subsequent to Hurricane Andrew, which struck south Florida in 1992. Many construction shortcomings were realized when damage was reviewed after the storm. That review led to significant modification of the code.

The Federal Emergency Management Agency (FEMA) establishes construction standards within designated floodplains that must be adopted by local political jurisdictions for those jurisdictions to qualify for federal flood insurance.

State Regulation

States are allowed to modify the building code to meet area requirements, so long as those modifications are consistent with federal guidelines. F.S. 553, Building Construction Standards, adopts the Southern Building Code as the standard for all construction within the state. The code has been further strengthened beyond that established by federal guidelines. F.S. 553, Building Construction Standards, contains eight parts:

- Part I: Manufactured Buildings
- Part II: Accessibility by Handicapped Persons
- Part III: Trench Safety Act
- Part IV: Florida Building Code
- Part V: Thermal Efficiency Standards
- Part VI: Energy Conservation Standards
- Part VII: Standards for Radon-Resistant Buildings
- Part VIII: Building Energy-Efficiency Rating System

Other state statutes related to construction include F.S. 515, the Swimming Pool Safety Act and F.S. 468, Part XII, Building Code Administrators and Inspectors.

Local Regulation

Each county adopts its own code, within the federal and state guidelines. It is not unusual to find county or city codes that far exceed federal and state requirements.
CHAPTER 7 REVIEW QUESTIONS

1. An ________ lot is bounded on each side by another lot. A ______ lot may not be desirable due to car headlights shining into the home. Access to a ______ lot is over a narrow road or driveway with improvements located at the rear of the property. ______ lots and ______ lots may not conform to current zoning and building codes due to minimum frontage requirements.

2. The __________ of a building is located below ground and supports the building’s weight.

3. Older homes in Florida may have __________ foundations, which are constructed with the living area elevated above the ground on cement blocks. However, most Florida homes have ______ foundations, which are made of poured ______ with reinforced ______ rods.

4. __________ foundations are the most economical type of foundation and are often placed on _________, which are designed to prevent excessive settling or movement of the structure.

5. The ____________ is the load-bearing frame of the building, including the walls and roof.

6. __________ windows have only one pane of glass that is movable, as opposed to _______ windows that have upper and lower panes, both of which may be opened or closed. ______ windows have small horizontal panes which open and close together with a crank.

7. Insulation is rated according to its __________. The __________ value, the better the insulating characteristics of the material.

8. __________ insulation is blown into wall cavities and attic spaces. __________ insulation is a type of ______ insulation that comes in sheets and has a foil facing to reflect radiated heat. __________ insulation is piped into or sprayed into the desired area and allowed to dry.

9. _______ pipe becomes soft when heated and should never be used for hot water distribution.

10. Hot water tanks can build up internal pressure during the heating cycle. It is important that all tanks be protected from explosion by a well-functioning ______.

11. The capacity of a heating or air-conditioning system is rated in ____________.

12. Central air-conditioning systems operate by circulating liquid ________, usually Freon, which is under pressure, through copper tubing to an ____________, often located in the attic in older Florida homes. A ____________ is located outside the home. An air-conditioning system absorbs moisture, which is run to the outside of the home through a ____________.

13. A ____________ is a self-contained heating and cooling system. To create heat, the flow of refrigerant is reversed with a ____________ located in the outside unit. Because these units are slow to respond to the need for heat in extreme cold, many units also include a ____________ which is operated from an emergency heat setting on the thermostat.

14. Areas of the house that present a higher risk of electrical shock, such as kitchens and bathrooms, require _____________.

15. Federal, state, and local ____________ provide a set of rules that specify minimum standards for buildings and structures.
CHAPTER 7 PRACTICE EXAM

1. There are advantages and disadvantages to using wood or masonry framing. Which statement is INCORRECT?
   a. Masonry is a much better insulator than wood, which reduces cooling costs.
   b. Wood has a potential for termite infestation or other types of decay.
   c. Reinforced concrete block exterior walls are strong, but may develop cracks.
   d. Masonry blocks cannot be insulated.

2. Why are test borings of the soil important for deciding on the type of foundation?
   a. To establish the weight of the building
   b. To locate possible sources of termites
   c. To determine the soil’s weight-bearing capacity
   d. To locate the depth of the water table

3. Which of the following is NOT an example of federal regulation of the construction industry?
   a. F.S. 533 Building Construction Standards
   b. Model building code
   c. Southern Building Code
   d. FEMA standards for designated floodplains

4. Which type of door is prohibited for the use listed?
   a. Solid wood, interior bathroom door
   b. Solid wood, exterior side-garage door
   c. Hollow-core, metal interior door leading to the garage
   d. Hollow-core, wood interior bedroom door

5. Which of the following statements is correct regarding small cracks in the exterior surface of a masonry building?
   a. They always indicate structural damage.
   b. They are common.
   c. They are just as big a problem as large open cracks.
   d. They should be ignored.

6. What type of residential roof is required to have substantial anchoring to mitigate damage caused by hurricanes and strong storms?
   a. Flat
   b. Gable
   c. Barrel tile
   d. Shingle

7. Which type of roof is especially susceptible to wear from standing water?
   a. Flat
   b. Gable
   c. Barrel tile
   d. Shingle

8. What is one indication that an asphalt shingle roof is near the end of its useful life?
   a. Curling along the edges
   b. An expiration date stamped on the surface
   c. An abrupt change in color
   d. High humidity within the living space

9. Which system, referred to as an “on-demand” system, provides heated water only when needed?
   a. Heat pump
   b. In-wall gas heater
   c. Water heater with a 40-gallon tank
   d. Tankless water heater

10. What is the relationship between watts, amps, and volts?
    a. Amps = Watts x Volts
    b. Volts = Amps x Watts
    c. Watts = Amps x Volts
    d. Watts = Amps ÷ Volts

11. What type of piping material has been associated with leaking joints?
    a. PVC
    b. CPVC
    c. PB
    d. Copper
12. Which system uses the temperature of the subsoil to heat and cool a home?
   a. Radiant
   b. Geothermal
   c. Heat pump
   d. Steam

13. Which type of conductor, used in residential wiring, has been linked to fires due to expansion and contraction that can cause the connection to loosen?
   a. Aluminum
   b. Copper
   c. Gold
   d. Silver

14. What electrical device can be used to protect against overheating in an electrical system?
   a. Volt meters
   b. Circuit breakers
   c. Amp meters
   d. Load restrictors

15. Electrical circuits have three components: a source, a path, and a load. Which item is an example of an electrical load?
   a. Circuit breaker
   b. Power line providing electricity to a home
   c. Interior wiring in a home
   d. Clothes dryer
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CHAPTER 8

FAIR HOUSING LAWS

OVERVIEW
Real estate professionals have an ethical responsibility to all of their clients and customers. When it comes to fair housing laws, the responsibility is also a legal one. Civil rights laws in the real estate industry are designed to generate circumstances in which persons with similar financial means have similar choices when attempting to buy, lease, rent, or finance property. The laws are also designed to allow every person an opportunity to live in the place of their choice by creating an open and unbiased market.

Fair housing laws on the federal, state, and local levels affect every aspect of a real estate transaction. In this chapter, we will take a historical look at the fair housing laws, see which classes of individuals are protected, learn the exemptions to the laws, and find out how the laws are enforced. We will also look at your responsibilities as a real estate professional for following these laws as well as for seeing that both your sellers and buyers follow them, too.

OBJECTIVES
After completing this chapter, you should be able to do all of the following:

- List the protected classes that are covered by the fair housing laws
- Identify prohibited activities and violations
- Explain the exemptions to the fair housing laws
- Identify the civil rights protections provided under the Americans with Disabilities Act (ADA)
- Describe how the federal fair housing laws are enforced
- Explain key aspects of the Florida fair housing laws
- Discuss how to avoid discrimination when working with buyers and sellers and in advertising

FEDERAL FAIR HOUSING LAWS – A HISTORICAL PERSPECTIVE

The primary focus of the fair housing laws are to protect the public, prospective renters, and buyers of real estate from discrimination; however, these laws also offer protection for real estate professionals who are members of the protected classes. Before we talk about how the fair housing laws affect real estate practices, we’ll look at the actual laws, the areas of coverage, and when they were enacted.

Civil Rights Act of 1866

The original Civil Rights Act was enacted in 1866. It prohibits discrimination based on race in the purchase, sale, or lease of real property. It covers only race as a protected class and applies to everyone.
• **Race.** As a real estate professional, you must never indicate the racial or ethnic makeup of any area in your advertising, marketing, or any other representation to the public. You must not show a prospective buyer property in any area based on race, even if that request came from the buyer.

  Race refers to physical features and characteristics that may be associated with a racial or ethnic group. Showing homes to a buyer only in neighborhoods where they conform to the prevailing racial population is an example of illegal racial discrimination, referred to as steering.

**Federal Fair Housing Act**

In 1968, under Title VIII of the Civil Rights Act, the protections under the 1866 Act were expanded to add additional protected classes. This is known as the *Fair Housing Act*. The expanded protected classes include color, religion, and national origin.

How this affects you as a real estate professional is explained below.

• **Color.** You must never indicate the color, racial, or ethnic makeup of any area in your advertising, marketing, or any other representation to the public. You must not show a prospective buyer property in any area based on color, race, or ethnic makeup, even if that request came from the buyer.

  Color refers to a person’s skin color. Color is included separately from race because people can discriminate solely on color. For example, someone discriminates against another person whose skin is lighter or darker. Discrimination based on color occurs when a licensee uses skin color as a determining factor in any aspect of a real estate sales transaction.

• **Religion.** You must never indicate the religious makeup of any area in your advertising, marketing, or any other representation to the public. You must not show a prospective buyer property in any area based on religion, even if that request came from the buyer.

• **National origin.** You must never indicate the national origin of or language spoken by residents in any area in your advertising, marketing, or any other representation to the public. You must not show a prospective buyer property based on the language spoken in a given area, even if that request came from the buyer.

  In 1968, the Supreme Court in *Jones v. Mayer* ruled that discrimination based on race is strictly prohibited. This means there can be no exemptions or exceptions with regard to race.

  In 1974, the Housing and Community Development Act added sex to the list of protected classes. This affects you as follows:

• **Sex.** You must never indicate a preference for a buyer or tenant based on their sex in any advertising, marketing, or any other representation to the public. There may be an exception if the advertising is for a roommate in a cohabitation situation. (Advertising is discussed later in this chapter.)

  In 1987, a Supreme Court decision expanded the definition of race to include *ancestry.*
1988 Fair Housing Amendment

In 1988, the Fair Housing Act was expanded to include handicap and familial status. These are explained below.

- **Handicap.** With regard to discrimination, physical or mental disability (handicap) includes hearing, mobility, and visual impairments, such as chronic alcoholism, chronic mental illness, AIDS, AIDS Related Complex, and mental retardation. As with the other protected classes, you must never indicate a preference for or against a buyer or tenant based on a handicap, or state that a property is not handicap accessible in any advertising, marketing, or any other representation to the public. There may be an exception in advertising if a property is already handicap accessible.

  With regard to leasing of rental property, if a person has a physical or mental disability (handicap) that substantially limits one or more major life activities, has a record of such a disability, or is regarded as having such a disability, a property owner may not refuse to let the tenant make reasonable modifications to the dwelling or common use areas, at his or her expense, so he or she can use the housing.

  In some cases, the property owner may allow changes only if the tenant agrees to restore the property to its original condition when he or she moves. The property owner also may not refuse to make reasonable accommodations in rules, policies, practices, or services if necessary for the disabled person to use the housing. For example, a building with a "no pets" policy must allow a visually impaired tenant to keep a guide dog.

- **Familial status.** Unless a building or community qualifies as housing for older persons, it may not discriminate against families in which one or more children under 18 live with one of the following persons: a parent, a person who has legal custody of the child or children, or the designee of the parent or legal custodian, with the parent or custodian's written permission.

  Familial status protection also applies to pregnant women and anyone securing legal custody of a child under 18.

  Again, you must never indicate a preference for or against a buyer or tenant based on familial status, such as the family has children, the number of children a family has, or a woman in the family is pregnant.
Summary of Protected Classes

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<thead>
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<th>Year Added and Legislation</th>
<th>Protected Classes</th>
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<td></td>
<td>National Origin</td>
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<td>1988 Fair Housing Amendment Act</td>
<td>Handicap</td>
<td>Houses</td>
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<td>Family</td>
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SUMMARY OF PROHIBITED ACTS

Fair housing laws prohibit a number of discriminatory activities when dealing with real estate.

- In the sale and rental of housing, no one may take any of the following actions based on race, color, national origin, religion, sex, familial status, or handicap:
  - Refuse to rent or sell housing
  - Refuse to negotiate for housing
  - Make housing unavailable
  - Deny a dwelling
  - Set different terms, conditions or privileges for sale or rental of a dwelling
  - Provide different housing services or facilities
  - Falsely deny that housing is available for inspection, sale, or rental
  - For profit, persuade owners to sell or rent (blockbusting)
  - Deny anyone access to or membership in a facility or service (such as a multiple listing service) related to the sale or rental of housing

- A real estate brokerage may not:
  - Set or permit different fees for members of any protected class for membership in the MLS.
  - Deny or limit benefits accruing to members of the brokerage or organization based on those persons being members of any protected class.
  - Establish geographic boundaries, office location, or residence requirements for access to, or membership in, any real estate-related organization, based on an individual's membership in any of the protected categories.
• **A landlord may not:**

  o Refuse to let a tenant make reasonable modifications to the dwelling or common use areas, at the tenant’s expense, if necessary for a disabled person to use the housing. (Where reasonable, the landlord may permit changes only if the tenant agree to restore the property to its original condition when they move.)

  o Refuse to make reasonable accommodations in rules, policies, practices, or services if necessary for the disabled person to use the housing.

• **In mortgage lending,** no one may take any of the following actions based on race, color, national origin, religion, sex, age, familial status or handicap (disability):

  o Refuse to make a mortgage loan

  o Refuse to provide information regarding loans

  o Impose different terms or conditions on a loan, such as different interest rates, points, or fees

  o Discriminate in appraising property

  o Refuse to purchase a loan

  o Set different terms or conditions for purchasing a loan

• **In addition,** it is illegal for anyone to:

  o Threaten, coerce, intimidate, or interfere with anyone exercising a fair housing right or assisting others who exercise that right

  o Advertise or make any statement that indicates a limitation or preference based on race, color, national origin, religion, sex, familial status, or handicap. This prohibition against discriminatory advertising applies to single-family and owner-occupied housing that is otherwise exempt from the Fair Housing Act.

**Specific Violations**

Fair housing laws also prohibit these activities:

• **Steering or channeling.** *Steering (or channeling)* is the practice of directing homebuyers toward or away from homes in certain neighborhoods or in a multiunit building in order to preserve or alter the makeup of that neighborhood with respect to race, religion, sex, or national origin. This is a violation against a buyer by limiting choices.

• **Blockbusting.** *Blockbusting* is the practice of inducing owners to sell by telling them that persons of a protected class are moving into the neighborhood and the results will be detrimental to the neighborhood. This is a violation against a seller and is also known as *panic selling* or *panic peddling.* Even unusually heavy solicitation for listings in racially transitional neighborhoods may be unlawful. The use of terms or phrases, such as decreasing property values, bad schools, and undesirable elements are strictly prohibited.

• **Redlining.** *Redlining* is the illegal practice of refusing mortgage financing or insurance based on a specific geographical location, age of the property, the income level of the residents, or the racial composition of the area.
Fair Housing Poster (HUD Poster)

All brokers are required to display the Fair Housing Poster in their place of business. If a licensee is accused of discrimination, the burden of proof falls on the person who makes the accusation. However, if a broker does not display the poster, this fact in itself is evidence of discrimination and the burden of proof shifts to the broker.

This is an example of the HUD poster.

**EXEMPTIONS**

The fair housing laws allow for exemptions in some areas. However, please note there are no exemptions, exceptions, or excuses for racial discrimination.

To qualify for exempt status, the transaction must meet both of these two conditions:

1. The services of a real estate professional were not used
2. The advertising for the property was not discriminatory

Some exemptions to the laws enacted between 1968 and 1988 include the following:

- A private club may restrict rental or occupancy of its dwellings to members only, as long as the dwellings are not commercially operated. However, the club may not discriminate in its membership requirements.
• Owner-occupied properties of not more than four units are exempt, as long as
the owner has not used a real estate licensee in the transaction.

• Single-family housing is exempt if it is sold or rented without the use of a real
estate licensee as long as the private individual owner does not own more than
three such single-family homes at one time.

• Property owned by churches or fraternal organizations that is used for lodging of
its members is exempt provided that the church or organization does not
discriminate in the selection of members.

• Senior citizen housing is exempt under the following conditions:
  o 80% of the units are occupied by at least one person who is 55 years of age
    or older and if it publishes and follows policies and procedures that
demonstrate the intent to be 55 and older housing.
  o Housing is occupied solely by persons who are 62 years of age or older.
  o Housing is for the elderly or the poor and is financed or subsidized by state or
    federal government agencies.

AMERICANS WITH DISABILITIES ACT (ADA)

The Americans with Disabilities Act (ADA) gives civil rights protections to individuals
who have disabilities similar to those provided to individuals based on race, sex, national
origin, and religion. It guarantees equal opportunity in employment, public
accommodations, transportation, state and local government services, and
telecommunications.

The ADA was enacted in 1990 with the purpose of removing barriers for people with
disabilities. Properties open to the public must remove any barriers that limit access or
utility of the property for individuals with disabilities. The ADA also mandates design
specifications for multifamily dwelling units to provide accessible and usable common
areas for people with disabilities.

Some of the more common problems addressed by the ADA are:

• Wheelchair ramps
• Support bars in restrooms
• Wheelchair accessible toilets
• Raised lettering on elevator buttons
• Audible floor signals in elevators
• Cut out curbs
• Size of doorways and entrances
• Handicap parking spaces (at least one for every 25 regular spaces)
• Installation height of fire extinguishers

Since most real estate firms are public places, they fall into the ADA’s definition of a
public accommodation. Brokers should evaluate how this applies to physical changes
they might need to make to their office space to accommodate both employees and
clients.

In addition, brokers should alert their commercial and investor clients to the
existence of the law and the need to have their leases professionally evaluated and their
offices inspected for compliance. Owners of small businesses serving the public must
remove physical barriers that are readily achievable, which means easy to accomplish
without much difficulty or expense. The readily achievable requirement is based on the
size and resources of the business, so large businesses with more resources are
expected to take a more active role in removing barriers than small businesses.

The ADA also recognizes that economic conditions fluctuate. When a business has
resources to remove barriers, it is expected to do so; however, when profits are down,
the business may delay or reduce the barrier removal. Barrier removal is an ongoing
obligation. The owner is expected to remove barriers in the future as resources become
available.

New Construction and Renovation

If a client is planning to build a new building or renovate an existing one, they need
to consult the ADA Standards for the specific requirements. Renovations or
modifications are considered alterations when they affect the usability of the space. For
example, installing a new display counter, replacing fixtures or flooring, or replacing an
entry door are alterations. However, simple maintenance, such as repainting a wall, is
not considered an alteration by the ADA.

A model home in a real estate development is not normally required to comply with
the ADA. However, if the home is also the development’s sales office, the area where
the sales are conducted must comply with ADA, since it is a public accommodation.

ENFORCEMENT OF FEDERAL FAIR HOUSING LAWS

The federal fair housing laws are administered by the Office of Fair Housing and
Equal Opportunity (FHEO) under the direction of the secretary of the Department of
Housing and Urban Development (HUD). Any person who believes they have been
discriminated against may file a complaint with HUD within one year of the alleged act.
HUD can also initiate a complaint on its own.

When HUD receives a complaint, it starts an investigation. Within 100 days, HUD determines if there is reasonable
cause to charge discrimination or to dismiss the complaint. During the investigation period, HUD attempts to resolve the
complaint by getting assurance from the person against whom the complaint was filed that they will remedy the alleged
violation. This is called conciliation. A conciliation agreement must protect both the person who filed the complaint and the
public interest. If an agreement is signed, HUD takes no further action on the complaint. However, if HUD has reasonable cause to believe that a
conciliation agreement has been breached, HUD will recommend that the Attorney
General file suit.

If the case goes to an administrative hearing, HUD attorneys litigate the case for the
person who filed the complaint. That person may intervene in the case and choose to be
represented by their attorney instead. During the hearing, an Administrative Law Judge
(ALJ) considers evidence from both the complainant and the respondent. If the ALJ
decides that discrimination occurred, the respondent can be ordered to:

- Compensate for actual damages, including humiliation, pain, and suffering.
- Provide injunctive or other equitable relief, such as to make the housing available
to the complainant.
• Pay the federal government a civil penalty to vindicate the public interest. The maximum penalties are $16,000 for a first violation and $70,000 for a third violation within seven years.
• Pay reasonable attorney’s fees and costs.

In addition to or instead of filing a complaint with HUD, a person may file a suit in a state or federal court within two years of the alleged violation. If the court finds that discrimination has occurred, the person who filed the suit may be entitled to actual damages, punitive damages, and/or attorney’s fees and costs.

More than 27,000 fair housing discrimination complaints were filed in fiscal year 2011, according to HUD. Discrimination based on a person’s disability continued to be the largest single category of complaints. Of those complaints filed with HUD and its Fair Housing Assistance Program partner agencies, 55% were alleged disability discrimination, 32% were alleged discrimination based on race, and 12% were alleged discrimination based on family status. These numbers are consistent with the number and type of complaints received during the previous three years; however, in 2011, the total number of complaints dropped slightly over the 2010 total.

Note: A violation of the fair housing laws is also considered a violation of Florida Statute 475. Any real estate professional who is found guilty of a violation may also be subject to discipline by the Florida Real Estate Commission.

FLORIDA FAIR HOUSING LAWS

Florida Fair Housing Act

The Florida Fair Housing Act is outlined in Florida Statute Title XLIV, Chapter 760, Part II, Fair Housing Act (hereinafter referred to as F.S. 760). It declares that it is illegal to discriminate in the sale, rental, advertising, financing, or providing of brokerage services for housing. The Florida Fair Housing Act parallels the Federal Fair Housing Act.

According to the Florida Fair Housing Act, it is considered a violation of law if any discriminatory action is taken based on any of the protected classes:

• Race
• Color
• Religion
• Sex
• National origin
• Handicap
• Family status

Any broker is considered in violation of the law if they in any way suggest or encourage a homeowner to employ discriminatory intent to sell or rent their property. Some examples of discriminatory behavior include:

• Misrepresenting that a property is not available for sale or rental.
• Refusing to accommodate a disability by making changes to a property that are readily achievable and economically feasible.
• Intimidating or threatening any person who endeavors to employ any right under the fair housing act
55 and Older Housing

To qualify as a 55 and older housing, a community must meet one of two requirements: [F.S. 760.29(4)(a)]

- **Option A.** The housing community is designed, operated, and intended to assist elderly persons who are 62 years of age or older. The housing must be totally occupied by persons who are 62 years of age or older.

- **Option B.** The housing community is intended and operated for persons who are 55 years of age or older. The housing community must comply with the following requirements:
  - At least 80% of all the occupied units are occupied by at least one person who is 55 years of age or older.
  - The housing community publishes and adheres to policies and procedures that demonstrate its intent to be a provider of housing for older persons.
  - The housing community complies with rules established by HUD for verification of occupancy.

Unless a housing community complies with the requirements of a 55 and older housing community, the community cannot deny residence to a family with children under the age of 18.

**Administrative Penalty**

If a housing community knowingly provides fraudulent information for meeting requirements under the law, the community may be subject to a $500 administrative fine. [F.S. 760.34]

The Florida Commission on Human Relations (FCHR) has the right to institute civil action in court against any housing community if it is unable to obtain voluntary compliance from the community. The community may be subject to a fine of $10,000 for a first offense or up to $25,000 if the violator is found guilty of a previous offense within the last five years. The court may impose a fine of up to $50,000 if the violator was found guilty of two or more offenses in the past seven years.

For more information, please visit the Florida Commission on Human Relations Web site: www.fchr.state.fl.us.

**Stigmatized Properties**

Florida law does not considered it to be a material fact or defect if a property was the site of a murder, death, or suicide, therefore, these events do not need to be disclosed to a buyer. No legal action can be taken against a broker, licensee, owner, or property owner for failure to disclose such information. [F.S. 689.25]

If the property was inhabited by anyone with acquired immune deficiency syndrome (AIDS) or human immunodeficiency virus (HIV), it is also not considered a material fact and cannot be disclosed. These persons are afforded all protections under the Fair Housing Act.

It is illegal to discriminate against a qualified person in housing based on HIV or AIDS under both the Federal Fair Housing Act and the Florida Fair Housing Act.
WORKING WITH CLIENTS

When working with both sellers and buyers during the offer and negotiation process, you must avoid any actions that could be interpreted as discriminatory. Actions that would be judged as discriminatory include:

- Discrimination in the terms, conditions, or privileges of the transaction.
- Refusal to receive a legitimate offer or failure to transmit one.
- Refusal to negotiate with either party during the offer/counter offer process.
- Discrimination in negotiating or executing any item or service, such as title insurance, mortgage insurance, or loan guarantee.
- Insertion of any provision into a written contract that intends to prevent or restrict the conveyance, encumbrance, occupancy, or lease of the property to individuals in a protected class or any attempt to honor such a provision.
- Insertion into a lease or purchase and sale agreement any condition, restriction, or prohibition that directly or indirectly limits the use or occupancy of the property to persons in a protected class or the attempt to honor such a condition or restriction.

It is not necessary for you to have the intention to discriminate for there to be a violation. If you act in a way that is perceived as discriminatory, you could actually be violating fair housing laws. Many actions could be perceived as discriminatory, so you would be wise to look at your sales practices and make sure that you act in ways that will keep you in compliance under any circumstances. You could implement several practices to help keep you in compliance.

- Ask all of your buyers the same questions when trying to prequalify them. Use a standard form or checklist of questions for every client so that you will have documentation that you have treated everyone in the same manner.
- Never give any member of a protected class the impression that they will have a harder time getting financing and never imply that to the sellers.
- Be sure to offer to show all of the properties in your area that meet the needs your clients have indicated. Never assume that you know what your clients need or want, especially when choosing neighborhoods.
- Treat everyone in the same way when setting up and conducting showings, making appointments to write offers, and negotiating offers.
- If you detect any discriminatory behavior in a seller, either in word or action, tell your broker about it without delay.
- Be watchful for any seller whose rejection of an offer appears to have discriminatory implications and ask your broker or your firm’s attorney how you should handle the situation if it occurs.
Compliance When Listing

It is critical for you to be familiar with the antidiscrimination laws and to be mindful of what kinds of activities the laws prohibit. Ignorance is not an excuse. In fact, under certain circumstances even actions with good intentions can be viewed as discriminatory.

Example:

Barbara, a broker, gives a listing presentation at the home of Mr. and Mrs. Sanchez, a Latino couple who, although they speak some English, are difficult to understand. Barbara becomes uncomfortable about this, but doesn’t say anything. After the presentation, Mr. and Mrs. Sanchez tell her that they want to list their home with her. Since Barbara knows a Spanish-speaking broker, Roberto, she suggests that the couple may want to list their property with him. However, Mr. and Mrs. Sanchez decided that they want to list the property with Barbara. She insists they would be better served if they listed with Roberto. Even though Barbara’s intentions are good and she feels that she is giving helpful advice to the couple, her actions could be considered discriminatory based on national origin. If she refuses the listing, she could be violating fair housing laws.

Most real estate professionals do not intentionally act in a discriminatory way or say things that they know are discriminatory. However, you need to be very aware of what you are saying at all times. It may seem innocent enough to tell racial or ethnic jokes, and make disparaging remarks about particular groups of people does not mean that you would actually discriminate in a real estate transaction. However, saying those types of things can lead to the assumption on the part of a buyer or a seller that you are racist or bigoted. In addition, if you stand by while someone else makes potentially discriminatory remarks, it can appear that you agree with those attitudes.

When performing a listing presentation, it is important for you to go over the fair housing laws with the prospective seller. You must stress to the seller that you will adhere strictly to those laws. It is also critical that the seller agree to comply with antidiscrimination laws. If a seller will not make that commitment, you should refuse to take the listing. You should also refuse the listing if the seller makes comments that suggest that they might act in a discriminatory way. If you decide not to take a listing because you suspect a potential discrimination problem, report the situation to your employing broker.

Handling Difficult Questions

Even though you do not intend to get yourself into a situation that could be perceived as discriminatory, you have no control over the behavior of your potential buyers and sellers. Consumers could easily ask questions that can get you into trouble.

When on the telephone, potential purchasers might ask for the racial make-up of a neighborhood, ask if a particular neighborhood is safe, or ask if the make-up of a neighborhood would hurt the resale value of the property. When meeting with a consumer face-to-face, a seller might ask that you show the property only to specific groups or that you do not show the property to particular races. A purchaser might ask for a specific neighborhood, school district, or church district. This is discriminatory if the request is based on the desire to be with or to avoid a particular protected class.
Other questions that you may be asked include:

- How many white, black, Hispanic, or Asian families live in this neighborhood?
- What color are the neighbors?
- Is there a group home for mentally retarded persons in the neighborhood?
- Has anyone in the seller’s family had AIDS?
- Can you show my home only to Christians?
- Will the racial make-up of the neighborhood affect resale?
- Do I have to sell to a family with children?

Whatever the question, there is only one acceptable answer to any questions regarding protected classes. That answer is, “I am prohibited by federal law from discussing race, color, religion, national origin, sex, handicap, and familial status.”

**ADVERTISING**

Compliance with antidiscrimination laws is also critical when advertising. *Discriminatory advertising* is defined as advertising that indicates a preference, limitation, or discrimination based on race, color, religion, sex, national origin, handicap, or familial status. However, it is often tricky to know what actually represents discriminatory advertising.

It is probably safe to say that any advertising that describes the property would be considered acceptable, while advertising that describes buyers might be considered discriminatory, especially if the buyers are from a protected class.

Always use the Equal Opportunity logo or slogan in all of your advertising.

**Writing Advertising Copy**

It can be challenging to create advertising that does not use some discriminatory words or phrases. Words that are not generally recognized as being discriminatory can be, so it’s important to become familiar with those phrases that you should avoid.

In 1995, HUD, which enforces fair housing laws, sent some guidelines to its staff to help them when investigating allegations of discrimination. The memo addressed some words and phrases that are not acceptable to use and others that, if used, would not constitute a violation or be considered discriminatory. The HUD memo addressed only a small set of possibilities, but it indicated that the staff should not move complaints forward if the ads appeared reasonable and did not favor or disfavor a protected group.

Organizations have published lists of words to help write ads that avoid discrimination. One particularly good list was compiled by the Miami Valley Fair Housing Center, Inc., in Dayton, Ohio. It’s called the *Fair Housing Advertising Word and Phrase List*.

To view and/or print the Fair Housing Advertising Word and Phrase List, please visit the Miami Valley Fair Housing Center Web site: [www.mvfairhousing.com](http://www.mvfairhousing.com)

The complete list is provided on the following page.
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<td>22</td>
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<td>23</td>
<td>Assistance animal(s)</td>
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<td>Irish, no</td>
</tr>
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<td>Italian, no</td>
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<td>27</td>
<td>Bachelor</td>
<td>28</td>
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</tr>
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<td>31</td>
<td>Bisexuals, no (City of Dayton)</td>
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<td>Landmark reference</td>
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<td>Chicanos, no</td>
<td>42</td>
<td>males(s) only**</td>
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<td>children, no</td>
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<td>man (men) only**</td>
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<td>45</td>
<td>Chinese</td>
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<td>mature couple</td>
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<td>mature individuals</td>
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<td>51</td>
<td>Colored Congregation</td>
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<td>Convalescent home</td>
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<td>membership available</td>
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<td>55</td>
<td>Convenient to</td>
<td>56</td>
<td>Membership approval required</td>
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<td>Couple</td>
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<td>59</td>
<td>couples only</td>
<td>60</td>
<td>Mentally ill, no</td>
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<tr>
<td>61</td>
<td>Credit check required</td>
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<td>crippled, no</td>
<td>64</td>
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<td>Den</td>
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<td>disabled, no</td>
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<td>Muslim</td>
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<td>employed, must be</td>
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<td>Nanny’s room</td>
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<td>79</td>
<td>empty nesters</td>
<td>80</td>
<td>Nationality</td>
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<td>81</td>
<td>English only</td>
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<td>Near</td>
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<td>83</td>
<td>Equal Housing Opportunity</td>
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<td>Negro, no</td>
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<td>non-smokers</td>
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<td>families welcome</td>
<td>94</td>
<td># of bedrooms</td>
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<tr>
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<td>96</td>
<td># of children</td>
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<td>98</td>
<td># of persons</td>
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<td>female roommate**</td>
<td>100</td>
<td># of sleeping areas</td>
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<td>female(s) only**</td>
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<td>103</td>
<td>55 and older community*</td>
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<td>nursing home</td>
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<td>Gays, no</td>
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<td>golden-agers only</td>
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<td>perfect for (should not describe people)</td>
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<td>Philippine or Philippinos, no</td>
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<td>140</td>
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<td>142</td>
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<td>Quiet neighborhood</td>
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<td>single woman, man**</td>
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<td>211</td>
<td>sixty-two and older community*</td>
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<td>217</td>
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<td>sober</td>
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<td>222</td>
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<td>223</td>
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<td>225</td>
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<td>226</td>
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<td>227</td>
<td>Square feet</td>
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<td>228</td>
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<td>229</td>
<td>Straight only student(s)</td>
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<td>235</td>
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<td>237</td>
<td>temple, near</td>
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<td>238</td>
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<td>239</td>
<td>tenant (description of)</td>
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<td>241</td>
<td>Townhouse</td>
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<td>243</td>
<td>traditional neighborhood</td>
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<td>245</td>
<td>traditional style</td>
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<td>247</td>
<td>tranquil setting</td>
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<td>Transgenders, no (City of Dayton)</td>
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<td>250</td>
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<td>251</td>
<td>two people</td>
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<td>253</td>
<td>Unemployed, no</td>
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<td>254</td>
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<td>255</td>
<td>Verifiable Income</td>
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<td>256</td>
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<td>257</td>
<td>walking distance of, within</td>
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<td>258</td>
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<td>259</td>
<td>Wheelchairs, no</td>
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<td></td>
<td>261</td>
<td>White White(s) only</td>
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<td></td>
<td>263</td>
<td>winter rental rates</td>
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<td>264</td>
<td></td>
<td>265</td>
<td>winter/summer visitors*</td>
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<tr>
<td>266</td>
<td></td>
<td>267</td>
<td>woman (women) only**</td>
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</table>
The legend and additional notes for the Fair Housing Advertising Word and Phrase List are:

*BOLD — not acceptable  ITALIC — caution  STANDARD — acceptable*

* Permitted to be used only when complex or development qualifies as housing for older persons

** Permitted to be used only when describing shared living areas or dwelling units used exclusively as dormitory facilities by educational institutions.

All cautionary words are unacceptable if utilized in a context that states an unlawful preference or limitation. Furthermore, all cautionary words are "red flags" to fair housing enforcement agencies. Use of these words will only serve to invite further investigation and/or testing.

This word and phrase list is intended as a guideline to assist in complying with state and federal fair housing laws. It is not intended as a complete list of every word or phrase that could violate any local, state, or federal statutes.

This list is intended to educate and provide general guidance to the many businesses in the Miami Valley that create and publish real estate advertising. This list is not intended to provide legal advice. If you are in need of legal advice, please see an attorney. By its nature, a general list cannot cover particular persons’ situations or questions. The list is intended to make you aware of and sensitive to the important legal obligations concerning discriminatory real estate advertising.

**Newspaper Advertising**

Newspaper ads make up a large proportion of the advertising for real estate professionals. These newspaper ads should not give so much as a hint of discrimination, even unintentionally.

To be safe, use a wide variety of newspapers so you don’t give an impression of racial steering. For example, if you list a home in a predominantly minority neighborhood, be sure to advertise it in a citywide newspaper and not just the local neighborhood paper.

When using pictures of people in your advertising, be sure the pictures show diversity.
Tips to Avoid Discrimination in Advertising

Here are some tips to help you avoid discriminatory phrasing in your advertising:

- **Race, color, or national origin.** If you use words that describe the housing, the current or potential residents, or the neighbors or neighborhood in racial or ethnic terms, you will create liability for discriminatory advertising. However, if you create ads that are racially neutral, you will have no liability.

  **Example:**

  Discriminatory phrases: “white family home” or “no Italians”

  Nondiscriminatory phrases: “private setting,” “rare find,” or “quiet neighborhood”

- **Religion.** If you create an ad that is explicit in its preference for or limitation of any particular religion, the ad is discriminatory. If you create an ad that contains descriptions of properties or services that do not indicate a preference for the kind of person who would use those facilities, the ad would not be considered discriminatory.

  **Example:**

  Discriminatory phrases: “no Jews,” “shrine,” or “parish”

  Nondiscriminatory phrases: “apartment complex with chapel” or “kosher meals available.”

- **Sex.** If you write an ad for a single family home or a separate unit in a multi-family dwelling, the ad must not have an overt preference for or limitation of any person that is based on sex unless the ad is describing shared living areas or homes used exclusively as dormitories by educational institutions. Other terms may reference sex, but since they are commonly used as physical descriptions of housing units, they are not considered discriminatory advertising.

  **Example:**

  Discriminatory phrases: “males only,” “men only,” “women only,” or “females only”

  Nondiscriminatory phrases: “mother-in-law apartment,” or “master bedroom”

- **Handicap.** You should never write a real estate advertisement that contains explicit exclusions, limitations, or other indications of discrimination based on handicap. On the other hand, advertisements that include descriptions of the property, services or facilities, or neighborhoods are not considered discriminatory advertising. You could also describe in an ad the conduct that is required of residents without it being viewed as discriminatory. For example, you could use the phrases non-smokers or sober. It is also within the law to write an ad that gives descriptions of accessible features, such as wheelchair ramp.
Example:

Discriminatory phrases: “no wheelchairs,” “able-bodied persons only,” “no deaf,” or “no handicapped parking”

Nondiscriminatory phrases: “great view,” “fourth-floor walk-up,” “walk-in closets,” “jogging trails,” or “walk to bus-stop,” “non-smokers” or “sober”

- **Familial Status.** You should never write an advertisement that contains limitations on the number or ages of children, or state a preference for adults, couples, or singles. Advertisements that include descriptions of the property, services or facilities, or neighborhoods are not considered discriminatory advertising.

Example:

Discriminatory phrases: “couples only,” “empty nesters,” “single person,” “no families,” “mature individuals,” or “senior discount”

Nondiscriminatory phrases: “two bedroom,” “cozy,” “family room,” “no bicycles allowed,” or “quiet streets”
CHAPTER 8 REVIEW QUESTIONS

1. The Civil Rights Act of 1866 prohibited discrimination in the purchase, sale, or lease of real property based on __________ only. The Federal Fair Housing Act expanded protection in 1968 and 1974 to include __________, __________, __________, and __________. The 1988 Fair Housing Amendment added __________ and __________ to the list.

2. Fair housing laws do not allow exemptions for ______ under any circumstances.

3. A landlord may not refuse to let a tenant make __________ modifications to the dwelling or common use areas, at the __________ expense, if necessary for a disabled person to use the housing.

4. __________ is the illegal practice of directing homebuyers toward or away from homes in certain neighborhoods or in a multiunit building in order to preserve the makeup of that neighborhood. This is a violation against a buyer by ____________________.

5. __________ is the illegal practice of inducing owners to sell by telling them that members of a protected class are moving into the neighborhood and the results will be detrimental to the neighborhood. This violation against the seller is also known as ____________________.

6. __________ is the illegal practice of refusing mortgage financing or insurance based on a specific geographical location, age of the property, income level of the residents, or the racial composition of the area.

7. All brokers are required to display the ____________________ in their place of business. If this is not displayed, the burden of proof against an accusation of discrimination by a licensee may shift from the accuser to the __________.

8. Except for __________ discrimination, some real estate transactions may be exempt from fair housing laws. To qualify for exemption, a real estate transaction must meet both of the following conditions: (1) the services of a ____________________ were not used, and (2) the ____________________ for the property was not discriminatory.

9. The ____________________ gives civil rights protections to individuals who have disabilities. Under this law, properties ____________________ must remove any barriers that limit access or utility of the property for individuals with disabilities.

10. Under the ADA, owners of small businesses serving the public must remove physical barriers that are ____________________, which means easy to accomplish without much expense. The ADA also mandates design specifications for new or renovated buildings, including __________ dwellings.

11. During a complaint investigation, HUD attempts to get a ____________________ agreement from the person against whom the complaint was filed stating that they will remedy the alleged violation.

12. The maximum civil penalty for a first time fair housing violation is ____________.

13. A violation of the Florida Fair Housing Act (F.S. _____) is also considered a violation of F.S. _____.

14. It is not necessary for you to intend to discriminate for there to be a violation. If you act in a way that is ____________ as discriminatory, you could be violating fair housing laws.

15. If you decide not to take a listing because you suspect a potential discrimination problem with the seller, you should report the situation to _____________________________.

Florida Real Estate Sales Associate Post-License Course
Reicon Publishing
CHAPTER 8 PRACTICE EXAM

1. Fair housing law exemptions do NOT exist for which protected class?
   a. Race
   b. Sex
   c. Religion
   a. Handicap

2. When must a fair housing complaint be filed with the HUD?
   a. Within five years of the occurrence.
   b. Within three months of the occurrence.
   c. Within six months of the occurrence.
   d. Within one year of the occurrence.

3. Which law extended discrimination to include handicap and familial status?
   a. Civil Rights Act of 1866
   b. Housing and Community Development Act
   c. Civil Rights Act of 1968
   d. 1988 Fair Housing Amendment

4. Which of the following is the acceptable response when a client asks you about the racial make-up of a neighborhood?
   a. "That is not something I'd know about. I do not pay attention to things like that."
   b. "I am prohibited by federal law from discussing race, color, religion, national origin, sex, handicap, and familial status."
   c. "I don't think you'd really fit in there - you probably want a safer area."
   d. "I get the feeling this would really be your type of neighborhood since the people here are just like you and your family."

5. Which of these transactions, if performed without the use of a real estate professional, is NOT an exemption to the fair housing laws?
   a. Sale of a home in a development for residents 55 or older
   b. Rental of a home by a religious organization that provides housing to members only and does not discriminate in the selection of its members
   c. Sale of a single-family home, when the owner owns five single-family residences
   d. Rental of a unit in an owner-occupied four-family house

6. A building or community may not discriminate based on certain familial status. Which familial status is NOT protected by fair housing law?
   a. At least one adult with children under 18 years of age
   b. An illegal drug user under 18 years of age
   c. A person who is pregnant
   d. A person who is in the process of securing legal custody of a child

7. What is the term used to describe the practice of influencing owners to sell because of the possible entry into the area of people of a certain race or color?
   a. Redlining
   b. Steering
   c. Residential blocking
   d. Blockbusting

8. A housing community in Florida claims to be an "over 55 community." Which condition is NOT required for the community to be in compliance with Florida law?
   a. The community publishes and follows the policies and procedures required for housing of older persons.
   b. At least one 55 or older person resides in 80% or more of the occupied units.
   c. HUD verification of occupancy rules are followed.
   d. No one under age 55 occupies any unit.

9. Broker Sandra accepted a listing for a home. A week later, the owner told her that he was not willing to sell to an African-American person or family. Which of the following is true?
   a. Sandra should abide by the owner's wishes.
   b. She should restrict her advertising to venues that cater to the African-American community.
   c. Sandra should explain to the owner that the request is in violation of the Fair Housing Act and she cannot abide by it.
   d. She should have the owner document the request in writing and file it with the listing agreement.
10. **The purpose of the fair housing law is to protect the public, prospective renters, and buyers of real estate from discrimination. Which action is NOT protected?**
   a. A seller refuses to negotiate with a buyer due to the buyer’s religion.
   b. A broker limits a sales associate from working anywhere other than in communities predominantly occupied by people of the same ethnicity as the sales associate.
   c. A seller refuses to negotiate with a buyer who cannot provide a 20% cash down payment.
   d. A renter with children under the age of 18 must pay a higher rent due to the age of the children.

11. **Carl has a habit of directing minority clients to the south end of town because he feels they would be more comfortable in that neighborhood. What is this practice called?**
   a. Blockbusting
   b. Redlining
   c. Panic selling
   d. Steering

12. **Dan has violated the fair housing law for the third time in seven years. How much could his fine be?**
   a. $10,000
   b. $25,000
   c. $70,000
   d. $100,000

13. **Which of the following should always be included in any advertising for residential property?**
   a. Photos of models from the same ethnic group as the target neighborhood
   b. Photos of models from a different ethnic group than the target neighborhood
   c. The Equal Housing Opportunity slogan or logo
   d. A description of the racial demographics of a community

14. **Which action would most likely NOT be required by the Americans with Disabilities Act?**
   a. A broker might need to change the layout of the office to make the aisles wider for clients in wheelchairs.
   b. A duplex owner might need to remodel the kitchen in the rental unit to accommodate persons with disabilities.
   c. An apartment manager might be required to allow a tenant with a disability to widen a doorway.
   d. During a remodeling project, a shopping center could be required to make changes to the public restrooms to allow wheelchair accessibility.

15. **Which of these phrases is acceptable for use in advertising?**
   a. White family home
   b. Christian home
   c. Couples only
   d. Wheelchair ramp
CHAPTER 9

CLOSING REAL ESTATE TRANSACTIONS

OVERVIEW

Once a seller accepts your buyer’s offer on a property, you move into the next phase of the transaction. The buyers will apply for financing, order inspections, and get a preliminary title report. The seller will pay off any liens against the property, arrange for any repairs, and execute the deed. These activities are all part of the closing process that leads up to and includes the final settlement of the transaction.

A good part of your job as a real estate professional is to help your buyer and seller through the closing process. For the most part, your client will be unaware of how the process works and will have numerous questions. They will want to know how long it takes to close the sale, what their responsibilities are, and how much money they will need to complete the sale. The seller will want to know how much cash they will receive on the day of closing.

Once the day of closing approaches, you will need to walk them through the charges that appear on the Closing Disclosure and help them through the stresses of signing all the documents. In this chapter, we will cover all the things you need to do from contract to closing date in order to help your buyer successfully navigate this process.

OBJECTIVES

After completing this chapter, you should be able to do all of the following:

- Describe your responsibilities during the pre-closing phase
- Discuss working with closers, home inspectors, and appraisers
- Describe the different types of insurance the buyer will need
- Explain the charges found on the Closing Disclosure
- Identify and calculate items that are typically prorated or prepaid between the buyer and seller
- Calculate state transfer taxes
- Discuss the final steps in the closing process

THE CLOSING PROCESS

After your buyer has a signed and valid contract for a real estate transaction, you must begin the process of facilitating that transaction through the closing process. Someone needs to move that transaction through an orderly step-by-step procedure in an organized manner. Some large brokerage firms may have support staff to handle this process. Support staff is overhead. That translates into more company dollars needed to pay for the support and, therefore, fewer dollars for you per transaction. However, having others handle these details frees you to spend more time generating transactions. Smaller brokerage firms tend to let the associates handle this process to keep overhead costs down. In times when fewer transactions are available, this might be a more practical approach.

The secret to good planning is to anticipate things that might happen and be prepared to take timely and appropriate action to eliminate or at least mitigate them before they become a problem. If you are able to do this and to explain to your buyer what and why you are doing it, your buyer will see your professionalism. This will bolster
their confidence in you as their real estate professional. Moreover, it is great advertising.

Using Checklists

Licensees often create checklists to ensure that all tasks and responsibilities are handled in a timely manner and that nothing is overlooked. In addition to the list of items to do, there should also be a place for the scheduled date, the actual date when the responsibility was met or completed, and the initials of the person who completed the task. A good checklist will help to ensure that nothing is missed along the way and all requirements are met in a timely manner. The contract, company policy, legal requirements, and local customs in your area dictate what goes into the checklist.

Closing Responsibilities Checklist

One such checklist is the “Closing Responsibilities Checklist.” Your real estate firm may already have such a list. Your checklist may list assignments for both the listing associate and the selling associate. If the transaction is in-house, where the listing and selling associates work for the same broker, coordination should be easy. However, you might have other occasions in which a buyer is represented by a cooperating broker. In these cases, you’ll need good organization and communication skills to coordinate the assignment and execution of the necessary duties and responsibilities.

The following is a brief summary of the possible tasks that need to be completed prior to closing. These items should be on your checklist.

- **Copies of the contract.** The buyer, seller, cooperating broker, title closing agent, and lender must receive legible, clean copies of the fully executed contract.

- **MLS status.** The listing brokerage should change the MLS status as the transaction progresses.

- **Yard sign.** Attach a rider to the yard sign to indicate the status, if applicable.

- **Loan application.** The buyers need to submit the loan application, unless they are paying cash.

- **Inspection and insurance.** Any Inspections and homeowner hazard insurance need to be ordered.

- **Contingencies.** Contingencies may need to be cleared, such as inspection, appraisal, and loan approval. When all contingencies have been met, an associate should update the MLS status to “pending” and perhaps a new rider on the yard sign would be appropriate.

- **Repairs.** Later on in the process, the sellers may need to schedule repair work identified in the inspection and arrange access for such work.

- **Closing agent.** The clients may need to select a closing agent, if the sellers had not already done this at the time they signed the listing agreement. The closing agent will require certain information and copies of some documents, such as a copy of the seller’s deed, previous title insurance policy, and existing mortgage information. It is helpful if the sellers have the survey from when they purchased.
- **Utilities.** Coordination between the sellers and the buyers is helpful when arranging for the switching over of the utilities effective the day of closing.

- **Closing date and location.** Near the end of the process, the appropriate associate should inform the parties of the time and place of the closing.

- **Walk-through.** The walk-through inspection of the property must be scheduled.

- **Escrow funds.** Any escrowed funds must be delivered to the closing agent.

- **Post-closing tasks.** No job is complete until all the paperwork is done. Post-closing tasks include changing the MLS status to “sold,” collecting and delivering commission checks and copies of the Closing Disclosure. The listing associate should remove the yard signs and both the listing and selling associates should review the files for completeness (your broker may have a checklist) and then close those files.

### MLS and Signs

If you were allowed to display a yard sign while the property was actively listed for sale, then you should immediately amend the sign upon changes in status, perhaps with a rider to indicate the appropriate status, such as “Contingency,” “Under Contract,” or “Pending or Sold.” Formerly, the Florida Real Estate Commission (FREC) had a rule forbidding the display of a “Sold” sign until the transaction actually closed. That rule has been repealed and now you have a choice as to which rider you would prefer to use.

Many associates prefer to use “Contingency” as a rider because they believe this will generate more calls by prospective buyers, resulting in additional prospects. Some associates believe that using “Sold” on the sign tends to end any buyer interest in that property and eliminates calls from other associates who may have a buyer. Others think using “Sold” is better advertising and may impress the neighbors. Of course, if the sale fails to close, it may defeat that purpose. Many feel that accuracy and preciseness about the status is best. It is up to you as to which rider to use.

Some associates have learned that leaving a “Sold” sign in the yard for about a week after the closing is good advertising. They have found that giving the buyer a housewarming gift helps put the buyer in the frame of mind to allow you to leave your sign up for a while.

If the subject property is listed in the MLS, the rules say you must change the status of that listing as and when it is appropriate. For example, when a contract has been accepted by the seller, but there is a contingency, you should change the status to “Contingency.” When the contingency has been cleared, change the status to “Pending.” When the transaction closes, change the status to “Sold” and submit the required information. Not only does it benefit all real estate professionals to have up-to-date and accurate data in the MLS, but also most MLS systems have rules that require members to keep listings current. This means that you should update the status in a timely manner, usually within just a few days of any status change.
Working with Home Inspectors

Early in the process, soon after the effective date of the contract, the property needs to be inspected. Your buyer may want a satisfactory inspection report before submitting a loan application. A seller may want the loan application submitted prior to the inspection, or at least at the time the inspection is being conducted, in order to speed up the process. This is another example of why working with a preapproved buyer is advantageous. A seller will be less concerned about the time to get the inspection done if the buyer has been preapproved for the loan.

If you represent the buyer, advise them to order the inspection quickly. If the buyer needs to use multiple inspectors, advise your buyer that they should coordinate the inspections so they are conducted at the same time. This will save time and costs. You should coordinate with each inspector to ensure they have access to both the property and the community if needed. Stay with the inspector while the inspection is being performed to ensure that they are being thorough. Ask the inspector to deliver copies of the report immediately to both the buyers and sellers. If the report calls for any significant repairs, further negotiations between buyer and seller may be necessary.

The State of Florida requires home inspectors to be licensed through the Department of Business and Professional Regulation (DBPR). [F.S. 468] An applicant for a license as a home inspector must complete a 120-hour pre-license course that covers a home’s structure, electrical system, HVAC system, roof covering, plumbing system, interior components, exterior components, and site conditions that affect the structure. Applicants must also pass a DBPR-approved examination, submit to a criminal background check, fingerprinting, be of good moral character, and obtain a $300,000 commercial general liability insurance policy.

Choosing a Home Inspector

Your buyer may ask for help in selecting an inspector, especially if they are not from the area. Remember the basic rule all associates should obey, “act responsibly, but do not take on responsibility that is not yours.” When making a recommendation, remember the “rule of three.” Give the buyer the names and phone numbers of at least three professionals who you know will do a good job. This allows you to avoid the appearance of endorsing a particular third party. Also, have the buyer call to order the inspection. Do not take on the responsibility of ordering the inspection because you could become liable for paying for it.

If the buyer chooses the inspector and they end up being unhappy with the work, it was their choice, not yours, that caused their unhappiness. This is especially important in situations where you need to avoid the appearance of a conflict of interest, usually in a Transaction Broker relationship when you are working with both buyers and sellers.

When considering which home inspector to engage, your buyer should consider the following five important items:

1. **Avoid choosing an inspector who has a conflict of interest.** The buyers should be cautious when engaging the services of an inspector who will profit from any repair action recommended. While most home inspectors are honest despite a possible conflict of interest, the buyer may wish to use only inspection services that do not also provide remedial services to correct any discovered deficiencies.
2. **Inspection is limited to what can be readily observed.** Significant problems may not be detected without looking under a floor or inside a wall. It’s rare for a seller to tolerate that kind of large-scale intrusion even if they are promised that the property will be returned to its original condition.

3. **Ask about home inspection standards.** The buyer may wish to verify that the home inspection will be conducted according to the standards of practice established by the National Association of Certified Home Inspectors (NACHI).

4. **Consider a walk-through inspection.** The buyer may want to employ the home inspector to accompany them on a final walk-through inspection of the property prior to the actual closing, after the seller’s personal property has been removed from the premises, and any agreed-upon repairs are completed.

5. **Consider an inspection of new construction.** Finally, note that even a builder can make mistakes or cut corners to save money, so your buyer might consider having a home inspection of new construction as well.

### The Home Inspection Contract

Even though the contract for home inspection services is between the buyer and the home inspector, it is the buyer’s responsibility to know what is contained in that contract. However, it would be wise for you to inform the buyer of the scope of a home inspection. You should tell the buyer that it is common for a home inspection contract to exclude certain activities from the general home inspection service. Generally, a standard home inspection contract lists the following exclusions:

- Wood-destroying organisms (WDO)
- Mold, mildew, and fungi
- Lead-based paint
- Radon gas
- Asbestos
- Septic tanks
- Drinking wells
- Docks
- Sea walls
- Hazardous substances

The buyer may have to engage the services of separate specialized inspectors, who will then supplement the general home inspector’s work.

### The Home Inspection

To ensure a smooth home inspection process, it is crucial that the seller and listing agent cooperate fully with the home inspector. This means that the property should be prepared for the home inspection. The following suggested items will help the home inspection to proceed expeditiously.

- Make certain that all utilities are turned on.
- Make sure that all gas pilot lights, if any, are on.
- Ensure that all appliances are connected and operable.
- Remove laundry from washers and dryers.
- Remove dishes from dishwasher.
1. Remove pots and pans from cooking equipment.
2. Remove objects and dishes from sinks.
3. Clear objects and furniture away from any electrical outlets.
4. Clear access ways to attic hatches and crawl spaces.
5. Clear access ways to heating/air conditioning systems.
6. Clear access ways to hot water heaters.
7. Clear access ways to electrical panel, water, and gas meters.
8. Make certain that all circuit breakers, or fuses, are operable.
9. Make sure all electrical outlets and switches cover plates.
10. Make sure that all smoke and carbon monoxide detectors are operable.
11. Ensure that all remote controls have good batteries and are operable.
12. Replace burned-out light bulbs.
13. Test all window and door locks for proper function.
14. Do a general cleanup of house odors, dirt, and clutter.
15. Do a general cleanup of yard of trash, fallen branches, debris, and animal waste.
16. Disarm alarm systems during inspection.
17. Control children during inspection.
18. Control pets during inspection.
19. Try not to use the water, gas, and electricity during inspection.
20. Provide as much access as possible around storage areas, garages, and basements.
21. Provide inspector with any relevant documentation of repair/replacement work.
22. Provide access through any gates.
23. Provide all keys.
24. Provide access to the home itself at the appointed inspection time.

A general home inspection concentrates on eight areas of the home:

- Structural elements
- Exterior evaluation
- Roof and attic
- Plumbing
- Systems and components
- Electrical
- Appliances
- Garages and storage

Lenders are particularly interested in two inspection reports. Lenders want to know that the roof is watertight and that the structure is free of wood destroying organisms (WDO).

If you are working with the buyer, be sure that they schedule these inspections and receive the reports in time to meet contract deadlines. An important point to stress with your buyer is that lenders require WDO reports that are no more than 30 days old at time of closing. Because closings often take place more than 30 days after the inspection, you should negotiate with the inspector to provide an updated report that is dated within 20 days of the planned closing. This would allow for a postponement of the closing without incurring the expense of another inspection.

**TIPS!**

Anticipate and plan to avoid problems.
Loan Application

If the buyer has chosen to finance the purchase, the contract will specify a deadline by which the buyer must submit a loan application. Most sales contracts contain wording that require the buyer to start a loan application within a minimum number of days from the effective date of the sales contract. Failing to meet the deadline constitutes a default by the buyer. If you’re working with the seller, it is your obligation to keep them informed of any buyer default. Of course, if you’re working with a buyer who has been preapproved for a loan, life is less complicated and moving the process along is easier and faster.

As part of the loan application and approval process, lenders will order a title report, which consists of three parts: a survey, a physical inspection, and a public records search. If the seller has a survey available from when they purchased, it is possible to order an updated survey from the original surveyor, thereby saving money on the cost of the survey. Once again, this item has all of the payment and access considerations aforementioned with various inspection items. If a survey uncovers any problems or encroachments, then the associate will likely be involved with sellers to help settle any of these matters.

Earnest Money and Additional Deposits

While the law doesn’t require an earnest money deposit for a valid real property sale and purchase contract, most real estate professionals understand that a substantial earnest money deposit is very helpful two ways:

- To convince the seller of the buyer’s earnestness, and
- To hold the buyer to their word since backing out of the sale can be costly.

Experience has shown that transactions with substantial deposits have a higher rate of closing than transactions without substantial deposits.

A deposit may be in the form of money, personal property, real property, or anything of value that is capable of being converted into cash. Typically, the deposit is intended to become a partial payment of the purchase price at closing. Postdated checks are considered to be promissory notes and can be accepted as earnest money with the seller’s approval. [F.A.C. 61J2-14.008(1)(a)]

Your employing broker is ultimately responsible for the proper handling of any earnest money deposits. However, Florida Real Estate Commission (FREC) rules do not require brokers to maintain escrow accounts. Maintaining an escrow account generates a lot of administrative overhead and requires periodic audits of the brokerage office by the Department of Real Estate (DRE). Many smaller brokerage firms are tending to forego maintaining an escrow account for these reasons and are opting to use a third party’s account, such as the escrow account of a title company or an attorney.

Whether or not your brokerage office maintains an escrow account, FREC rules regarding timely deposits of escrow funds still apply. You are required to deliver any escrow deposit to your broker prior to close of business the next business day. The broker is required to have funds deposited in an escrow account prior to close of business the third business day following the original receipt of the funds.

The sale and purchase contract may call for the buyer to make a secondary deposit within a specified number of days from the effective date of the contract. FREC rules on
timely deposits apply to the secondary deposits, too. If the buyer fails to deliver funds as specified in the contract, the buyer is in default.

FREC rules for placing an escrow deposit with a title company or attorney, F.A.C. 61J2-14.008(2)(6), require the following:

- The licensee who prepared or presented the sales contract must indicate on the contract the name, address, and telephone number of the title company or attorney that will act as the escrow agent.

- Within ten business days after each deposit is due under the sales contract, the licensee's broker will make a written request to the title company or attorney to provide written verification of receipt of the deposit.

- Within ten business days of the date the licensee's broker made the written request for verification of the deposit, the licensee's broker will provide the sellers' broker with either a copy of the written verification, or, if no verification is received by licensee's broker, written notice that licensee's broker did not receive verification of the deposit. If the sellers are not represented by a broker, then the licensee's broker will notify the sellers directly.

An effective way to comply with these rules and to simplify the process is to provide the title company or attorney with an appropriate receipt that contains all of the required information when the check is delivered. Then the person who accepts the check needs only to sign it, thereby acknowledging receipt of the check. Experience has shown that title company personnel and attorneys are glad to avoid the work of producing a form, so they will readily sign your receipt. Keep a copy in your files, and make sure that both the buyer and seller receive a copy.

**Choosing the Escrow Agent**

Who chooses the title company or attorney who will hold the escrow funds is often determined by custom in your area or by the agreement between the buyer and seller. For instance, if the custom in your area is for the seller to provide the buyer with a title insurance policy, the seller chooses where to shop based on the idea that the one who pays gets to choose. However, if the contract calls for the buyer to purchase their title insurance, then the buyer would choose the escrow agent. Those who pay, make the choice.

Experienced sales associates who are good at planning will usually bring this to the seller's attention shortly after securing the listing and before getting an offer. This practice will give the seller time to shop for a title-closing agent. An effective way to do this is to provide your seller with a list of three closing agents who you know will do a good job.

The closing agent is often one who is in the area where the subject property is located. All title insurance is sold at the promulgated rate, but the charges for doing the closing can vary. Therefore, you need to provide your clients with a list of questions to ask the closers about their charges for handling the closing. Let the sellers pick whom they will use.

On the other hand, if it is likely that the buyer will purchase their own title insurance, give them the list, and ask them to select before they are ready to make an offer. When the buyer makes this choice prior to making any offers, you know to whom the buyer should make their deposits payable. This will cause the title company or attorney to hold the checks from the start of the process and will avoid the hassle of having the checks delivered to the closers just prior to the actual closing. In addition, you'll have one less item on your checklist to worry about.
Working with Appraisers

After developing the comparative market analysis (CMA) that helped your seller to establish a reasonable listing price, you and your seller should feel confident that the negotiated sale price on the signed sale and purchase contract is a good indication of the market value of their property. However, the big question is whether the lender’s appraiser will develop a value for the property equal to or near that value.

It is not unusual for the appraiser’s opinion of value to come in lower than the agreed upon sale price, thereby causing some number of transactions to fail. You have no control over these external realities. All you can do is to be aware of them and try to work around and through them.

Once an appraiser receives an appraisal assignment, they contact the listing associate to schedule a mutually convenient time to gain access to the subject property to conduct the appraisal. The appraiser inspects the property inside and out to gather information about updates, surrounding area, structural problems, square footage, measurements, improvements, and general condition of the property. Most appraisers both welcome and appreciate any relevant information the listing associate can provide that will help them to formulate their report. If you are the listing associate, you should make every effort to provide the appraiser with detailed information about upgrades, improvements, and condition aspects of the property. Additionally, you could give the appraiser the comparable property data that you used throughout the sales transaction. In addition, the appraiser will be most appreciative if you can furnish copies of a survey and/or floor plan that the sellers might have in their possession.

If the appraiser’s opinion of value ends up being lower than the sales price agreed to in the sales contract, there could be a big problem with financing. Most standard sales contracts contain a financing clause stipulating that the contract is contingent on the buyer obtaining a loan equal to a stated percentage of the purchase price or a stated dollar amount. Some associates take this a step further to protect their buyers by adding a term stating that the real property must appraise at the sales price or above to prevent a voided sales contract and the return of the escrow funds.

If this unfortunate event occurs, you and your seller have several options:

- You can contact the appraiser and question why they used lower comparable sales data, and inquire if any immediate closed sales data could change the outcome. Try to provide additional comparable and pending sales data that supports a higher value. You can call the listing agents of pending sales to try to find out the actual sales price of those properties. Listing agents do not have to disclose the sales price, but many are happy to help because they could find themselves in the same situation.

- The seller could agree to lower the sales price to the appraised value because they would most likely be presented with similar future appraised valuations if they put their property back on the market.

- The buyer could add additional cash to the offer, reducing the loan to value ratio, which could result in lender approval.

- The seller could hire a second appraiser to do a second independent appraisal if they are not convinced of the trustworthiness of the first appraisal.
• The buyer could try another lender with a different appraiser, although there is no guarantee that the new appraisal will produce different results.

• The seller could make corrections to the property if there were specific defects that had a negative impact on the appraisal results.

• The seller could offer a second mortgage to the buyer.

The reality is that you have no control over the appraisal process. All you can do is provide the best information available to the appraiser. Whether the appraiser uses the information is beyond your control.

**Advising Your Buyer About Insurance**

Most likely, the buyer will be responsible for the purchase of a new hazard insurance policy along with any needed insurance coverage riders, such as flood insurance. The associate working with the buyers should advise them to accomplish this task as soon as possible. It is common practice for most insurance carriers operating in Florida to place a moratorium on writing new policies during the period of time any named storm is in the box. *The box* is a huge geographic area surrounding Florida, the Gulf of Mexico, the Caribbean, and all the islands within many hundreds of miles of our coast. Any named storm that appears within the box could significantly delay a closing, which would probably have a serious impact upon both parties. Once obtained, you need to verify that a copy of the new policy will be forwarded to the closing agent, since the closing agent will have to comply with lender instructions.

You need to help your buyer to understand the three types of insurance that they will be dealing with during and after the closing of their property: property, flood, and title insurance.

**Property Insurance**

Lenders require *property insurance*, which is frequently referred to as *homeowner’s insurance*, for all homes purchased with financing. Lenders require adequate insurance coverage on the property so that if the home is damaged or destroyed by fire or storm, the insurance will cover the cost to repair or replace the home. These policies usually provide the homeowner with liability coverage to protect the owner if someone is injured on the property.

The standard property insurance policy generally includes four types of insurance coverage as outlined below.

- **Structural coverage.** The structure coverage includes a deductible amount that the property owner agrees to pay out of pocket, which is subtracted from any insurance claim amount the insurance company pays. Coverage for damage caused by most types of common risks (such as fire, smoke, hail, lightning, vandalism, theft, etc.) has predetermined limits on the dollar amounts the insurer will pay for the repair or replacement. Although most lenders require that the property owner insure the property for the mortgage amount, the property owner needs to have enough coverage limits for the cost to rebuild the home in the case of a catastrophe.
• **Personal property coverage.** Most policies cover the owner’s personal property, which includes the contents of the home, such as furniture, clothing, etc. These items are usually covered, whether stolen or damaged in an insurable event. Typical coverage for personal property is about 50% to 75% of the dollar amount of coverage for the structure.

Advise your clients to create a detailed inventory list of their possessions and update it when they make new purchases. They should keep a copy of it offsite, such as in a safety deposit box. Property owners can buy additional coverage called *floaters* for specific inventoried items, such as fine art, jewelry, guns, furs, etc.

• **Additional living expenses coverage.** This part of the coverage provides the necessary funds to pay for alternate accommodations when the property owner is unable to reside in the property during the construction or repair period. The usual coverage for additional living expenses is 20% of the coverage amount for the structure or the coverage may be limited to the actual expenses incurred during a 12-month period.

• **Liability protection coverage.** This coverage protects the homeowner against claims, or lawsuits, for bodily injury or property damage that any member of the household caused, unintentionally or negligently, to other people and other property. In addition, this type of coverage allows an injured person to submit medical bills to the property owner's insurance company. In addition, this coverage will pay for both the legal costs of defending a property owner in a court of law as well as any court judgment awards up to the maximum limits stated in the policy.

**Flood Insurance**

*Flood insurance*, protection from damage due to flooding, is not provided in standard homeowner insurance policies. Flood insurance can be purchased through the Federal Emergency Management Agency (FEMA).

To identify a community’s flood risk, FEMA conducts a Flood Insurance Study. The study includes statistical data for river flow, storm tides, hydrologic/hydraulic analyses, and rainfall and topographic surveys. FEMA uses this data to create the flood hazard maps that outline different flood risk areas. Floodplains and areas subject to coastal storm surge are shown as high-risk areas or Special Flood Hazard Areas (SFHAs). Some parts of floodplains may experience frequent flooding while others are only affected by severe storms. However, areas directly outside of these high-risk areas may also find themselves at considerable risk.

Changing weather patterns, erosion, and development can affect floodplain boundaries. FEMA is currently updating and modernizing the nations Flood Insurance Rate Maps (FIRMS). These digital flood hazard maps provide an official depiction of flood hazards for each community and for properties located within it. Flood insurance rates are based on these flood maps.

For additional information on flood maps for communities in your area, please visit the FEMA Web site: www.fema.gov.
Congress mandated federally regulated or insured lenders to require flood insurance on properties that are located in areas at high risk of flooding. However, a lender can require flood insurance, even if it is not federally required. In high-risk areas, there is at least a 25% chance of flooding during a 30-year mortgage.

As a part of its efforts to keep FEMA financially sound, national legislation was recently passed to increase flood insurance rates to “actuarially sound” levels. This could result in annual flood insurance premium increases as high as 25%. This, combined with changes to the flood maps, is causing flood insurance to be a significant consideration in the purchase and financing of a home.

Whether required or optional, if flood insurance is being purchased, advise your buyers not to wait until a storm is on the way. Coverage will not begin until 30 days after they pay for the policy.

Title Insurance

Title insurance is indemnity insurance for lenders and property owners for protection against a host of possible legal and/or financial problems that may arise in the purchasing and/or financing of real property. Examples of such occurrences might include undisclosed liens, unpaid tax liens, legal judgments, forgeries, and fraud. There are two separate types of title insurance policies available: one for lenders, and one for property owners. They are normally issued as a package together called a simultaneous issue.

- **Lender’s policy.** The lender’s (or mortgagee’s) title insurance policy is generally required by all institutional lenders to protect their security interest, or collateral, for a real estate loan and it is issued for the loan amount. The lender usually requires the borrower to pay for this lender’s title insurance policy at the loan closing as a requirement to obtain the desired financing. The lender’s title insurance policy generally follows any assignment, or transfer, of the mortgage. This means that this lender’s title insurance policy is transferable to any purchaser of that mortgage loan if it is sold on the secondary mortgage market.

- **Owner’s policy.** The owner’s (or mortgagor’s) title insurance policy is issued for the purchase price amount and paid for at closing. It is good only for as long as the named insured owns the property; it is not transferable. Any new buyer would have to buy a new owner’s title insurance policy. This policy assures the buyer that the title to the property is free from all title defects, liens, and encumbrances except those that are stated as exclusions and exceptions to the coverage. The actual dollar amount paid for the title insurance policy can come from either the buyer or seller; it is a negotiable item in the offer to purchase. Not only do title insurance policies cover against losses from covered claims, but also they contain provisions for coverage of legal fees in defense of such claims. Extended owner’s coverage is also available for purchase that covers items such as building permits, covenants, violations of prior owners, incorrect mapping, future encroachments, forgeries, and fraud.

Unlike other insurance policies, claims, and payouts, the bulk of title insurance premium dollar amounts paid are used upfront to identify and eliminate potential title defects before any title problems occur. The objective is to avoid future claims and pay outs after the fact. Therefore, most title issues are discovered and resolved by title insurance companies before the settlement and closing takes place.
Clearing Contingencies

Many sale and purchase contracts contain contingencies, usually more than one. Contingencies include:

- An inspection report to buyer’s satisfaction
- An appraisal value equal to or greater than the agreed upon sale price
- Financing in the amount specified in the offer

Contingencies are driven by both the buyer’s desires and the lender’s demands. It is your job to see that contingencies are cleared in a timely manner.

Some sale and purchase contracts may contain specific replacement and/or repair contingency requirements that need to be addressed promptly. For example, the contract may call for the resealing of an in-ground swimming pool. Although, normally it is the seller’s responsibility to have this work completed, the sales associate working with the seller could help by providing names and phone numbers of contractors who do this kind of work. If the seller is out of town, you may offer to provide the contractors access to the property so they can give estimates to the seller. However, you should not order the work to be done; only the seller should initiate the work. Remember, act responsibly, but do not take on responsibility that is not yours. Good communication is the mark of a professional, so keep all parties informed on the progress of any work to be done. Using a checklist is an effective way to be sure nothing is missed.

Additional Closing Documentation

Closing agents require a lot of information to do their job. It is your job to see that the closer receives all the required information with a minimum of problems. The chosen title company will often have a complete checklist of all the information needed. If you get a copy of this checklist early, you can give the parties early notice of what will be required so they can have the information ready when it is needed. Remember, keep thinking ahead, and anticipate needs, both yours and others. Then take action early to meet those needs. Being organized makes life easier. Be sure to provide the closer with all of the information requested. Closers don’t ask for information they don’t need. Failing to give a closer all the information could cause a delay in the closing and a delay in your payday.

Most of the information required by the closer includes the following:

- A copy of the seller’s deed
- Previous title insurance policy, if any
- Previous property survey
- All existing mortgage information for all outstanding financing
- The full legal names, marital status, Social Security numbers, and complete contact information for all parties concerned, as well as all possible means of communication
- If the property in question is subject to a homeowners’ association or property management firm, the closer will also need complete contact information for these entities.
- Legible copies of the listing agreement and the sale and purchase contract will be required
- Any brokerage transaction fees and brokerage commission structure
Home Warranties

There are occasions when the seller has various maintenance contracts that cover home appliances, warranties, alarm system monitoring, etc. The question arises as to whether these contracts and warranties are transferable to the buyer. This is something you could suggest to the seller after you secure the listing. This practice gives the seller time to gather the information and make the necessary calls to determine the transferability. Deliver the information to the buyer a few days before closing.

RESPA REQUIREMENTS

The Real Estate Settlement Procedures Act (RESPA) is a federal law that was passed by the U.S. Congress in 1974. It has various important requirements that must be met in all financed residential real property sale and purchase transactions. The major purpose of RESPA is consumer protection. RESPA ensures that consumers throughout the nation are provided with more helpful information about the cost of the mortgage settlement and protected from unnecessarily high settlement charges caused by certain abusive practices.

RESPA is enforced by the Consumer Financial Protection Bureau (CFPB) per the federal legislation known as the “Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.”

RESPA applies to the following types of purchases:

- Residential property; one- to four-family homes, cooperatives, and condominiums involving first or second mortgages.

- Financed by a federally-related loans; loans that are insured by a federal agency, those that are insured or guaranteed by VA or FHA, HUD-administered loans, or those that are sold to Fannie Mae, Freddie Mac, or Ginnie Mae.

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

RESPA requirements include all of the following:

- Lenders must provide a Loan Estimate of settlement costs no later than three business days following the date of the mortgage loan application.

- Each loan applicant must receive the information booklet titled “Your Home Loan Toolkit,” which explains the various closing charges.

- The Closing Disclosure must be completed and provided to the borrower at least three days prior to closing.

- Lenders must provide a mortgage servicing disclosure statement, which discloses to the borrower whether the lender intends to service the loan or transfer it to another lender.
• Kickbacks and rebates are prohibited on any transaction regulated under the provisions of RESPA when a service has not been rendered. For example, an insurance company cannot pay a kickback to a real estate agent or to a lender for referring a client to their agency. Referrals for closing services are strictly prohibited, but referrals between real estate brokers are permitted. Generally, Florida law allows kickbacks and rebates if:

  o A service has been provided
  o All parties to the transaction have been informed
  o No other law is being broken, such as RESPA or a licensing law

THE CLOSING

When financing has been arranged and title issues, if any, have been resolved, it is appropriate to set the time and place of closing (settlement). The place of closing may have been established when the clients chose the title company. If that is the case then simply arrange a time that is acceptable for all parties, buyers, sellers, and the closing agent. The law does not require buyers and sellers to be present in order to close. It is just a matter of convenience to have both present. However, there are times when it is not convenient to get both parties to the closing table at the same time and there may be occasions when it is not prudent to have both parties together in the same room. If there is any animosity between the parties, it is best to keep them apart. Sometimes the closer may have to arrange a mail away closing to meet the needs of the parties. If one party will be out of town and it would cause great expense or inconvenience to return for the closing, documents can be sent via overnight mail to a real estate attorney who is located near where the party will be and can handle the closing. Real estate attorneys and title closing agents are familiar with the process and can help you coordinate this with your buyers or sellers.

In order to speed up the closing process and the disbursement of funds, including your commission, closing agents need to have cleared funds in their account. The funds in question include:

• The buyer’s earnest money
• Secondary deposit (if any)
• New bank loan
• The buyer’s balance to close (the rest of the down payment)

Cleared funds means the closer does not want checks delivered on the day of closing, not even bank checks and/or certified checks. There have been several incidents involving forged bank and certified checks. Many closing agents require wire transfers to avoid this problem. Wire transfers take time; sometimes banks need a 24-hour notice. Most of these issues are resolved by using the escrow account of the title company that will handle the closing.

If this is the case, make sure that you have told your buyer to schedule the transfer of funds for the time of closing.

• Give your buyer the routing number and the account number of the closer’s account.
• Ask your buyer speak with their banker to find out what is needed to schedule the transfer.

• Tell the buyer to ask how much lead-time the bank needs to ensure timely delivery of the funds.

If this is scheduled ahead of time, your buyer may need only to contact the bank to initiate and authorize the pre-arranged transfer. Then all you’ll need to do is review the Closing Disclosure with your buyer, which will show the cash they must have to close.

However, if you are still handling the escrow funds by using checks, you must deliver the checks several business days before the date of the closing to allow time for them to clear. However, if you’d like to keep your closers happy, change your procedure and use wire transfers.

Closing Disclosure

The transfer of title to real property from the seller to the buyer is conveyed via a deed at the title closing. The closing event itself is where the last of the obligations are met and the last of the promises are kept. This is when the buyer actually makes the purchase and delivers the purchase price, and the seller sell the property and deliver the marketable title through a deed.

The closing agent prepares an accounting of all of the expenses that the buyer and seller must pay. There are many costs related to the sale of the property (above-and-beyond the purchase price) that either the seller or buyer have agreed to pay. These are referred to as closing costs.

The sale and purchase contract signed by the buyer and seller is the document that controls what happens at the closing, and who pays which costs. The closer uses the contract to develop the numbers that go into the Closing Disclosure.

Closing Disclosure Explained

RESPA requires that the Closing Disclosure must be given to the borrower no later than three business days prior to settlement, if requested. The lender is held liable for the accuracy and timing of the buyer’s Closing Disclosure.

For this section, please refer to the Closing Disclosure found in the Forms Section of this book. The Closing Disclosure has these significant areas:

1. Closing Information. This section contains general information about the closing including the parties, the closing date, the sales price, etc.

<table>
<thead>
<tr>
<th>Closing Disclosure</th>
<th>Transaction Information</th>
<th>Loan Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Closing Information</td>
<td>Transaction Information</td>
<td>Loan Information</td>
</tr>
<tr>
<td>Date Issued</td>
<td>Borrower</td>
<td>Loan Type</td>
</tr>
<tr>
<td>Closing Date</td>
<td></td>
<td>□ Conventional □ FHA □ VA □</td>
</tr>
<tr>
<td>Disbursement Date</td>
<td>Seller</td>
<td>Loan ID #</td>
</tr>
<tr>
<td>Settlement Date</td>
<td></td>
<td>MIC #</td>
</tr>
<tr>
<td>File #</td>
<td>Property</td>
<td></td>
</tr>
<tr>
<td>Property</td>
<td>Lender</td>
<td></td>
</tr>
<tr>
<td>Sale Price</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
2. **Loan Terms.** This section contains information about the loan, including the loan amount, interest rate, payment, pre-payment penalty, and any balloon payment.

<table>
<thead>
<tr>
<th>Loan Terms</th>
<th>Can this amount increase after closing?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan Amount</td>
<td></td>
</tr>
<tr>
<td>Interest Rate</td>
<td></td>
</tr>
<tr>
<td>Monthly Principal &amp; Interest</td>
<td>See Projected Payments below for your</td>
</tr>
<tr>
<td></td>
<td>Estimated Total Monthly Payment</td>
</tr>
<tr>
<td>Prepayment Penalty</td>
<td>Does the loan have these features?</td>
</tr>
<tr>
<td>Balloon Payment</td>
<td></td>
</tr>
</tbody>
</table>

3. **Projected Payments.** This section includes payment calculations, mortgage insurance information, and estimated taxes, insurance, and assessments.

<table>
<thead>
<tr>
<th>Projected Payments</th>
<th>This estimate includes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment Calculation</td>
<td>In escrow?</td>
</tr>
<tr>
<td>Principal &amp; Interest</td>
<td>Property Taxes</td>
</tr>
<tr>
<td>Mortgage Insurance</td>
<td>Homeowner’s Insurance</td>
</tr>
<tr>
<td>Estimated Escrow Amount can increase over time</td>
<td>Other:</td>
</tr>
<tr>
<td>Estimated Total Monthly Payment</td>
<td>See Escrow Account on page 4 for details.</td>
</tr>
<tr>
<td>Estimated Taxes, Insurance &amp; Assessments</td>
<td>You must pay for other property costs</td>
</tr>
<tr>
<td>Amount can increase over time</td>
<td>separately.</td>
</tr>
<tr>
<td>See page 4 for details</td>
<td></td>
</tr>
</tbody>
</table>

4. **Costs at Closing.** This section includes the total closing costs and cash to close.

<table>
<thead>
<tr>
<th>Costs at Closing</th>
<th>Includes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Closing Costs</td>
<td>in Loan Costs + in Other Costs –</td>
</tr>
<tr>
<td></td>
<td>in Lender Credits. See page 2 for details.</td>
</tr>
<tr>
<td>Cash to Close</td>
<td>Includes Closing Costs. See Calculating Cash to Close on page 3 for details.</td>
</tr>
</tbody>
</table>
5. **Loan Costs.** This section includes origination charges, charges for services the borrower shopped for, and costs for services the borrower did not shop for.

<table>
<thead>
<tr>
<th>Loan Costs</th>
<th>Borrower-Paid</th>
<th></th>
<th>Seller-Paid</th>
<th></th>
<th>Paid by Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Origination Charges</td>
<td>At Closing</td>
<td>Before Closing</td>
<td>At Closing</td>
<td>Before Closing</td>
<td></td>
</tr>
<tr>
<td>% of Loan Amount (Points)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B. Services Borrower Did Not Shop For</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C. Services Borrower Did Shop For</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>D. TOTAL LOAN COSTS (Borrower-Paid)</td>
<td>Loan Costs Subtotals (A + B + C)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

6. **Other Costs.** This section includes taxes and government fees, prepaid items, initial escrow payment due at closing, along with other costs, such as homeowners’ association fees, real estate commission, title policy, etc.

<table>
<thead>
<tr>
<th>Other Costs</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>E. Taxes and Other Government Fees</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F. Prepaids</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>G. Initial Escrow Payment at Closing</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>H. Other</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I. TOTAL OTHER COSTS (Borrower-Paid)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>J. TOTAL CLOSING COSTS (Borrower-Paid)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
7. **Calculating Cash to Close.** This section compares the cash to close from the Loan Estimate with the actual cash to close from the buyer.

<table>
<thead>
<tr>
<th>Calculating Cash to Close</th>
<th>Use this table to see what has changed from your Loan Estimate.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Loan Estimate</td>
</tr>
<tr>
<td>Total Closing Costs ($)</td>
<td></td>
</tr>
<tr>
<td>Closing Costs Paid Before Closing</td>
<td></td>
</tr>
<tr>
<td>Closing Costs Financed (Paid from your Loan Amount)</td>
<td></td>
</tr>
<tr>
<td>Down Payment/Funds from Borrower</td>
<td></td>
</tr>
<tr>
<td>Deposit</td>
<td></td>
</tr>
<tr>
<td>Funds for Borrower</td>
<td></td>
</tr>
<tr>
<td>Seller Credits</td>
<td></td>
</tr>
<tr>
<td>Adjustments and Other Credits</td>
<td></td>
</tr>
<tr>
<td>Cash to Close</td>
<td></td>
</tr>
</tbody>
</table>

8. **Summaries of Transactions.** This section summarizes items due from the borrower, items already paid by the borrower, items due to the seller, and items due from the seller at closing, along with items prorated between the parties. The result is the net cash to/from the buyer and to/from the seller.

<table>
<thead>
<tr>
<th>Summaries of Transactions</th>
<th>Use this table to see a summary of your transaction.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BORROWER’S TRANSACTION</td>
<td></td>
</tr>
<tr>
<td>K. Due from Borrower at Closing</td>
<td></td>
</tr>
<tr>
<td>01 Sale Price of Property</td>
<td></td>
</tr>
<tr>
<td>02 Sale Price of Any Personal Property Included in Sale</td>
<td></td>
</tr>
<tr>
<td>03 Closing Costs Paid at Closing ($)</td>
<td></td>
</tr>
<tr>
<td>04 Adjustments</td>
<td></td>
</tr>
<tr>
<td>05</td>
<td></td>
</tr>
<tr>
<td>06</td>
<td></td>
</tr>
<tr>
<td>07</td>
<td></td>
</tr>
<tr>
<td>Adjustments for Items Paid by Seller in Advance</td>
<td></td>
</tr>
<tr>
<td>08 City/Town Taxes to</td>
<td></td>
</tr>
<tr>
<td>09 County Taxes to</td>
<td></td>
</tr>
<tr>
<td>10 Assessments to</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td></td>
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<tr>
<td>12</td>
<td></td>
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<td>13</td>
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<tr>
<td>14</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td></td>
</tr>
<tr>
<td>L. Paid Already by or on Behalf of Borrower at Closing</td>
<td></td>
</tr>
<tr>
<td>01 Deposit</td>
<td></td>
</tr>
<tr>
<td>02 Loan Amount</td>
<td></td>
</tr>
<tr>
<td>03 Existing Loan(s) Assumed or Taken Subject to</td>
<td></td>
</tr>
<tr>
<td>04</td>
<td></td>
</tr>
<tr>
<td>05 Seller Credit</td>
<td></td>
</tr>
<tr>
<td>Other Credits</td>
<td></td>
</tr>
<tr>
<td>06</td>
<td></td>
</tr>
<tr>
<td>07</td>
<td></td>
</tr>
<tr>
<td>Adjustments</td>
<td></td>
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<td>08</td>
<td></td>
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<tr>
<td>09</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td></td>
</tr>
<tr>
<td>Adjustments for Items Unpaid by Seller</td>
<td></td>
</tr>
<tr>
<td>12 City/Town Taxes to</td>
<td></td>
</tr>
<tr>
<td>13 County Taxes to</td>
<td></td>
</tr>
<tr>
<td>14 Assessments to</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td></td>
</tr>
<tr>
<td>16</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td></td>
</tr>
<tr>
<td>CALCULATION</td>
<td></td>
</tr>
<tr>
<td>Total Due from Borrower at Closing ($)</td>
<td></td>
</tr>
<tr>
<td>Total Paid Already by or on Behalf of Borrower at Closing ($)</td>
<td></td>
</tr>
<tr>
<td>Cash to Close □ From □ To Borrower</td>
<td></td>
</tr>
</tbody>
</table>

| SELLER’S TRANSACTION    |                                                               |
| M. Due to Seller at Closing |                                 |
| 01 Sale Price of Property |                                                               |
| 02 Sale Price of Any Personal Property Included in Sale |   |
| 03 Closing Costs Paid at Closing ($) |               |
| 04 Adjustments            |                                                               |
| 05                        |                                                               |
| 06                        |                                                               |
| 07                        |                                                               |
| Adjustments for Items Paid by Seller in Advance |   |
| 08 City/Town Taxes to     |                                                               |
| 09 County Taxes to        |                                                               |
| 10 Assessments to         |                                                               |
| 11                        |                                                               |
| 12                        |                                                               |
| 13                        |                                                               |
| 14                        |                                                               |
| 15                        |                                                               |
| 16                        |                                                               |
| N. Due from Seller at Closing |                                   |
| 01 Excess Deposit         |                                                               |
| 02 Closing Costs Paid at Closing ($) |   |
| 03 Existing Loan(s) Assumed or Taken Subject to |       |
| 04 Payoff of First Mortgage Loan |                       |
| 05 Payoff of Second Mortgage Loan |                     |
| 06                        |                                                               |
| 07                        |                                                               |
| 08 Seller Credit         |                                                               |
| 09                        |                                                               |
| 10                        |                                                               |
| 11                        |                                                               |
| 12                        |                                                               |
| 13                        |                                                               |
| 14                        |                                                               |
| 15                        |                                                               |
| 16                        |                                                               |
| 17                        |                                                               |
| 18                        |                                                               |
| 19                        |                                                               |
| CALCULATION               |                                                               |
| Total Due to Seller at Closing ($) | |
| Total Due from Seller at Closing ($) | |
| Cash □ From □ To Seller  | |
9. **Loan Disclosures.** This section provides disclosure of key loan features.

### Additional Information About This Loan

#### Loan Disclosures

- **Assumption**: If you sell or transfer this property to another person, your lender will allow, under certain conditions, this person to assume this loan on the original terms. □ will not allow assumption of this loan on the original terms.

- **Demand Feature**: Your loan □ has a demand feature, which permits your lender to require early repayment of the loan. You should review your note for details. □ does not have a demand feature.

- **Late Payment**: If your payment is more than ___ days late, your lender will charge a late fee of ____________

- **Negative Amortization (Increase in Loan Amount)**: Under your loan terms, you □ are scheduled to make monthly payments that do not pay all of the interest due that month. As a result, your loan amount will increase (negatively amortize), and your loan amount will likely become larger than your original loan amount. Increases in your loan amount lower the equity you have in this property. □ may have monthly payments that do not pay all of the interest due that month. If you do, your loan amount will increase (negatively amortize), and, as a result, your loan amount may become larger than your original loan amount. Increases in your loan amount lower the equity you have in this property. □ do not have a negative amortization feature.

- **Partial Payments**: Your lender □ may accept payments that are less than the full amount due (partial payments) and apply them to your loan. □ may hold them in a separate account until you pay the rest of the payment, and then apply the full payment to your loan. □ does not accept any partial payments.

- **Security Interest**: You are granting a security interest in ____________

You may lose this property if you do not make your payments or satisfy other obligations for this loan.

#### Escrow Account

- **For now, your loan** □ will have an escrow account (also called an "impound" or "trust" account) to pay the property costs listed below. Without an escrow account, you would pay them directly, possibly in one or two large payments a year. Your lender may be liable for penalties and interest for failing to make a payment.

<table>
<thead>
<tr>
<th>Escrow</th>
<th>Estimated total amount over year 1 for your escrowed property costs:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Escrowed Property Costs over Year 1</td>
<td>Non-Escrowed Property Costs over Year 1</td>
</tr>
<tr>
<td>Estimated total amount over year 1 for your non-escrowed property costs:</td>
<td>You may have other property costs.</td>
</tr>
</tbody>
</table>

- **Initial Escrow Payment**: A cushion for the escrow account you pay at closing. See Section G on page 2.

- **Monthly Escrow Payment**: The amount included in your total monthly payment.

□ will not have an escrow account because □ you declined it □ your lender does not offer one. You must directly pay your property costs, such as taxes and homeowner's insurance. Contact your lender to ask if your loan can have an escrow account.

<table>
<thead>
<tr>
<th>No Escrow</th>
<th>Estimated Property Costs over Year 1</th>
<th>Estimated total amount over year 1. You must pay these costs directly, possibly in one or two large payments a year.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Escrow Waiver Fee</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Loan Calculations

- **Total of Payments**: Total you will have paid after you make all payments of principal, interest, mortgage insurance, and loan costs, as scheduled.

- **Finance Charge**: The dollar amount the loan will cost you.

- **Amount Financed**: The loan amount available after paying your upfront finance charge.

- **Annual Percentage Rate (APR)**: Your costs over the loan term expressed as a rate. This is not your interest rate.

- **Total Interest Percentage (TIP)**: The total amount of interest that you will pay over the loan term as a percentage of your loan amount.
11. **Other Disclosures.** This section contains other required disclosures.

12. **Contact Information.** This section contains contact information for the lender, mortgage broker, real estate brokers, and settlement agent.

13. **Confirm Receipt.** The last section contains the applicant and co-applicant signatures to confirm receipt of this Closing Disclosure.
Closing Disclosure Proration and Prepayment Computations

As we mentioned earlier, some expenses are prorated between the parties at the time of closing based on their ownership days for that particular item. You should be competent in verifying the accuracy of the prorated expenses and explaining those items to your clients. The more common types of proration expenses are:

- Property taxes
- Community association fees
- Rent (if the purchase is an income-producing property)
- Mortgage interest on existing mortgages (applies to subject-to or assumed mortgage purchases)
- Utilities and insurance (These are rare but sometimes applicable.)

It is important to note that we are never calculating the amount that each party owes for any one expense. We are calculating only the prorated share of the one party who owes the money and then giving that amount of money to the other party.

Generally, when a seller has not yet paid for an item, and will do so at closing, it is referred to as a debit to the seller and is listed under the Adjustments for Items Paid by Seller in Advance section of the Closing Disclosure. Conversely, if there is a proration for an item which the seller has paid prior to the closing, the seller will receive a credit, and the proration amount will appear under the Adjustments for Items Paid by Seller in Advance section of the Closing Disclosure.

For most expenses, closers use an actual calendar, 365-day method for computing the items that need to be prorated. The closer can compute a daily rate for an item by dividing the annual cost by 365 days. Similarly, the closer can compute a daily rate by dividing the monthly cost for an item by the actual days in the month of closing. Once the closer obtains the daily rate, he or she multiplies the daily rate by the number of ownership days of the party that owes the expense. The calculated amount is posted to the Closing Disclosure as a debit to the party who owes the money and a credit to the other party.

Proration ownership days are usually counted through the day before the closing as belonging to the seller. The buyer owns the day of closing and thereafter. However, to whom the day of closing might belong, can be a negotiable item in the sales contract and/or determined by local custom in an area and stated accordingly in the sales contract.

Some items stated on the Closing Disclosure are a debit to one party only and are referred to as single entries. Typically, these single entries are expenses that only one of the parties to the transaction pays to an outside party (third party, not a participant in the transaction). Those expenses between the two parties to the transaction, with no third party involved, are double entries and most often result in a debit to the seller and a credit to the buyer.

Property Tax Proration

In Florida, the tax year is the calendar year (January 1st through December 31st) and property taxes are paid in arrears, which means that the tax is paid after the debt was incurred. Only one tax bill per year is mailed, and that is sent to the owner of record on November 1st.

If the closing takes place before November 1st, then the buyer will receive the tax bill for the whole year, even though the buyer did not own the property for the whole year. In this case, the seller is debited and the buyer will be credited with the seller’s prorated share of the tax bill, based on the previous year’s taxes, for the time that the seller had ownership.
However, if the closing takes place after November 1st, and the seller paid the tax bill for the whole year prior to closing, the buyer is debited and the seller will be credited with the buyer’s prorated share of the tax bill.

Remember, prorated expenses between the buyer and seller are always stated as double entries.

If the seller paid the taxes prior to closing, the entries would be on page 3 of the Closing Disclosure under the section titled Summaries of Transactions, Adjustments for Items Paid by Seller in Advance, as a debit to the buyer and a credit to the seller. The entries would be this way because the seller paid the taxes for the full year and the buyer must reimburse them for the portion of the taxes that are the buyer’s responsibility.

The reverse would be true, the double entry would be a debit to the seller, and a credit to the buyer, if the seller did not pay the taxes by the closing date and the buyer must pay the full tax bill when it is issued. In this case, the entries would be listed on page 3 of the Closing Disclosure, in the section titled Adjustments for Items Unpaid by Seller, shown below.

Example: Calculating property tax prorations.

If the prior year’s annual property taxes for a property was $1,000, and the closing is on May 3rd with the day of closing allocated to the seller, what is the amount of the tax proration using the 365-day method?

**Step 1** Calculate the number of days the seller has owned the property.

- 31 Days in January
- 28 Days in February
- 31 Days in March
- 30 Days in April
- + 3 Days in May
- 123 Days of seller ownership

**Step 2** Calculate the daily tax amount and multiply by the number of days of seller ownership to find the amount of tax owed by the seller to the buyer for the time they owned the property.

\[
\frac{($1,000 \text{ Taxes} \div 365 \text{ Days}) \times 123 \text{ Seller days}}{\text{Owed by seller}}
\]
Tip: To avoid rounding errors, use your calculator to do the calculation in one-step by entering “1000 ÷ 365 x 123” and then pressing “=”

### Step 3

Entries on the Closing Disclosure:
- $336.99 debit seller;
- $336.99 credit buyer

<table>
<thead>
<tr>
<th>BORROWER’S TRANSACTION (debit the buyer)</th>
<th>SELLER’S TRANSACTION (credit the seller)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjustments for Items Unpaid by Seller</td>
<td>Adjustments for Items Unpaid by Seller</td>
</tr>
<tr>
<td>12 City/Town Taxes to</td>
<td>14 City/Town Taxes to</td>
</tr>
<tr>
<td>13 County Taxes</td>
<td>15 County Taxes</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>14 Assessments to</td>
<td>16 Assessments to</td>
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<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td></td>
</tr>
</tbody>
</table>

### Community Association Monthly Fee Proration

In property tax proration, the starting point is the yearly property tax amount. In the case of community association fee proration, the starting point is the community association fee as a monthly expense. So, the daily rate for community association monthly fee proration computations is obtained by dividing that monthly fee by the number of actual days in the month of closing. In the example below, we will assume that the seller has paid the community association monthly fee on the first of the month.

**Note:** Some communities will charge their fees quarterly or even annually in advance.

**Example:** Calculating a community association monthly fee proration.

If the monthly community association fee is $200.00, and the closing is on July 20th with the day of closing allocated to the seller, what is the amount of the community association fee proration that the buyer owes?

#### Step 1

Calculate the number of days that the buyer owns the property.

\[
\begin{align*}
31 \text{ Days in July} \\
- 20 \text{ Day of closing} \\
11 \text{ Days buyer owns property}
\end{align*}
\]

#### Step 2

Calculate the daily rate of the association fee and multiply by the number of days the fee is owed by the buyer.

\[
($200.00 \text{ monthly fee ÷ 31 Days}) \times 11 \text{ Days} = $70.97 \text{ owed by buyer}
\]

Tip: To avoid rounding errors, use your calculator to do the calculation in one-step by entering “200 ÷ 31 x 11” and then pressing “=”
Entries on the Closing Disclosure: Debit the buyer $70.97; credit the seller $70.97. The entries should be placed in the section for Adjustments for Items Paid by Seller in Advance.

<table>
<thead>
<tr>
<th>BORROWER’S TRANSACTION (debit the buyer)</th>
<th>SELLER’S TRANSACTION (credit the seller)</th>
</tr>
</thead>
<tbody>
<tr>
<td>08 City/Town Taxes</td>
<td>09 City/Town Taxes</td>
</tr>
<tr>
<td>09 County Taxes</td>
<td>10 County Taxes</td>
</tr>
<tr>
<td>10 Assessments</td>
<td>11 Assessments</td>
</tr>
<tr>
<td>11 HOA Dues</td>
<td>12 HOA Dues</td>
</tr>
<tr>
<td>July 1 to July 1 to July 20 $70.97</td>
<td>$70.97</td>
</tr>
</tbody>
</table>

Rent Proration

In the case where the property is occupied by a renter, rent proration applies. Rent proration calculations are similar to community association monthly fee proration computations. The situation is that the seller, who is the current property owner and landlord, collected the rent from the tenant on the first of the month. The buyer will be the new property owner and will be responsible for the property beginning on the day of closing. Therefore, the buyer is entitled to a portion of the rent amount that was paid for the month.

When prorating, use the actual number of days that the buyer owns the property for the closing month. You are not calculating the amount of rent the seller gets to keep; you are calculating the amount of rent the seller owes the buyer. The resulting calculation will be a debit to the seller (Section N, Due from Seller at Closing) and a credit to the buyer (Section L, Paid by or on Behalf of Borrower at Closing).

Example: Calculating a rent proration.

If the monthly rent is $850.00 payable on the first of the month, and the closing is on September 14th with the day of closing allocated to the seller, what is the amount of the rent proration that the seller owes?

**Step 1** Calculate the number of days that the buyer owns the property.

\[
\begin{align*}
30 \text{ Days in September} \\
- 14 \text{ Day of closing} \\
16 \text{ Days buyer owns property}
\end{align*}
\]

**Step 2** Calculate the daily rate of the rent and multiply by the number of days the buyer owns the property to find the amount owed by the seller to the buyer for the rent already collected.

\[
($850 \text{ monthly rent} \div 30 \text{ Days}) \times 16 \text{ Buyer days} = 453.33 \text{ Owed by seller}
\]
Entries on the Closing Disclosure: Debit the seller $453.33; credit the buyer: $453.33. This type of entry usually appears on page 3 in Sections L and N.

### Existing Mortgage Interest Proration

Most mortgage loans have *due-on-sale clause*, which prevents a buyer from taking over the payments when they buy the property. However, some loans do not have this clause, such as VA loans. This presents the possibility of a buyer being financed, even if a lender is reluctant to lend to them. If the seller has a loan without a due-on-sale clause, the buyer may want to take over the payments with either the “subject to,” or “assumption of” method.

“*Subject to*” means that the buyer acknowledges the fact that the home they are buying has a lien against it, but the buyer does not accept any personal legal responsibility for the repayment of that debt. The buyer and the seller have privately contracted for this “subject to” purchase arrangement. If the buyer does not pay loan, the lender may foreclose and the buyer will lose the home. However, if the lender does not receive sufficient money from the foreclosure to satisfy the debt, the buyer cannot be held responsible. The lender would have to sue the seller based on the note they signed when the loan was originated. The seller is the only party who has a legal relationship and obligation with that lender. Thus, a “subject to” purchase is different from an assumed mortgage purchase with very different legal ramifications.

Whether it is a “subject to” or assumed mortgage, the method for calculating the proration is the same.

Interest on loans is usually paid in arrears and would need to be prorated between the buyer and seller for the month of the closing. As with other prorations we’ve discussed, the seller is responsible for the interest on the loan up to the day of closing and the buyer is responsible for the interest from the day of closing onward. This requires a debit to the seller for their portion of the interest and a credit of that amount to the buyer. So, when the buyer makes the next monthly mortgage payment, they have the seller’s portion of the interest due with that payment.

No principal reduction in the loan balance is prorated because the buyer is making a subject to or assumed purchase based upon the loan balance at the time of closing. Any principal reduction in that loan balance resulting from the buyer’s mortgage payment on the first of the month following the closing rightfully belongs to the buyer.

### Example
Calculating interest proration for a “subject to” or assumed mortgage.

If the monthly interest for the existing mortgage for the month of closing is $498.75, and the closing is on May 17th with the day of closing allocated to the seller, what is the amount of the interest proration that the seller owes?
Step 1  
The seller owns the property for 17 days in May.

Step 2  
Calculate the daily interest rate and multiply by the number of days the seller owns the property/loan to find the interest amount that the seller owes the buyer.

\[
\frac{498.75 \text{ Interest}}{31 \text{ Days}} \times 17 \text{ Seller days} = 273.51 \text{ Owed by seller}
\]

Step 3  
Entries on the Closing Disclosure: Debit the seller $273.51; credit the buyer $273.51. This type of entry usually appears on page 3 in Sections L and N.

<table>
<thead>
<tr>
<th>BORROWER’S TRANSACTION (debit the buyer)</th>
<th>SELLER’S TRANSACTION (credit the seller)</th>
</tr>
</thead>
<tbody>
<tr>
<td>L. Paid Already by or on Behalf of Borrower at Closing</td>
<td>N. Due from Seller at Closing</td>
</tr>
<tr>
<td>01 Deposit</td>
<td>01 Excess Deposit</td>
</tr>
<tr>
<td>02 Loan Amount</td>
<td>02 Closing Costs Paid at Closing ($)</td>
</tr>
<tr>
<td>03 Existing Loan(s) Assumed or Taken Subject to</td>
<td>03 Existing Loan(s) Assumed or Taken Subject to</td>
</tr>
<tr>
<td></td>
<td>$273.51</td>
</tr>
<tr>
<td>04</td>
<td>04 Payoff of First Mortgage Loan</td>
</tr>
<tr>
<td>05 Seller Credit</td>
<td>05 Payoff of Second Mortgage Loan</td>
</tr>
<tr>
<td></td>
<td>06</td>
</tr>
<tr>
<td>Other Credits</td>
<td>07</td>
</tr>
<tr>
<td>07</td>
<td>08 Seller Credit</td>
</tr>
<tr>
<td>Adjustments</td>
<td>09</td>
</tr>
<tr>
<td></td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>11</td>
</tr>
</tbody>
</table>

Prepayment of Mortgage Interest Computations

Prepayment computations are involved in any transaction that involves a new loan. If the buyer finances the purchase of a property with a new loan, they have to pay the lender for the use of the money beginning on the day of closing through the last day of the month.

Example:

If closing is on May 14th, the borrower would not make the first loan payment on June 1st, but rather on July 1st. Since interest is paid in arrears (after the fact), the July 1st payment would include the interest on the new loan for the month of June. However, the bank loaned the money to the borrower on May 14th, and it wants the interest on that money for the period of May 14th through May 31st. Hence, the lender expects a prepayment of interest that must be paid at the time of closing.

In the case of interest prepayment, the day of closing must be included in the number of days that the borrower has the use of the money. In this example, the borrower had the use of that money for 18 days in May.

Note: This is not a prorating problem between the buyer and the seller because the seller is not involved (unless the seller is the lender in a purchase money mortgage situation). This is between the buyer/borrower and the lender.
Prepayment of mortgage interest on a new loan to a lender is a one-time payment that is based upon simple interest. The lender uses a 365-day method to calculate the interest due. The lender multiplies the loan amount by the stated annual interest rate and divides by 365 to get the daily rate.

**Example:** Calculating prepayment of mortgage interest.

If the interest rate is 12% on a $120,000 mortgage loan, and the closing is on December 10th, what is the amount of the interest that they buyer owes the lender on the day of closing?

**Step 1**
Calculate the number of days for which the buyer owes interest to the lender.

<table>
<thead>
<tr>
<th>Days in December</th>
<th>Day of closing</th>
</tr>
</thead>
<tbody>
<tr>
<td>31</td>
<td>- 10</td>
</tr>
</tbody>
</table>
| 21 Days of interest due = 22 (21+1 = 22 since the buyer owes interest for the day of closing.)

**Step 2**
Calculate the annual interest amount on the loan.

\[
\begin{align*}
\text{Annual interest amount on the loan} &= \frac{\text{Mortgage loan amount}}{\text{Annual interest rate on the loan}} \\
&= \frac{$120,000}{0.12} \\
&= $14,400
\end{align*}
\]

**Step 3**
Calculate the daily interest amount due and multiply by the number of days that the buyer owes interest to find the interest amount due to the lender from the buyer.

\[
\begin{align*}
\text{(Interest)} &= \frac{\text{Annual interest amount on the loan}}{365} \\
&= \frac{$14,400}{365} \\
&= $39.45 \text{ Interest per day (rounded)}
\end{align*}
\]

\[
\begin{align*}
\text{(Interest)} &= \left(\frac{\text{Annual interest amount on the loan}}{365}\right) \times 22 \\
&= $867.95 \text{ Owed to lender}
\end{align*}
\]

**Step 4**
Entries on the Closing Disclosure: Debit the buyer $867.95.
This is a single entry on page 2 in the section titled Other Costs, F. Prepaids.

<table>
<thead>
<tr>
<th>Other Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>E. Taxes and Other Government Fees</td>
</tr>
<tr>
<td>01 Recording Fees</td>
</tr>
<tr>
<td>02</td>
</tr>
<tr>
<td>F. Prepaids</td>
</tr>
<tr>
<td>01 Homeowner’s Insurance Premium</td>
</tr>
<tr>
<td>02 Mortgage Insurance Premium</td>
</tr>
<tr>
<td>03 Prepaid Interest ($39.45 per day from 12/16 to 12/31)</td>
</tr>
<tr>
<td>04 Property Taxes</td>
</tr>
<tr>
<td>05</td>
</tr>
<tr>
<td>G. Initial Escrow Payment at Closing</td>
</tr>
<tr>
<td>01 Homeowner’s Insurance</td>
</tr>
<tr>
<td>02 Mortgage Insurance</td>
</tr>
<tr>
<td>03 Property Taxes</td>
</tr>
<tr>
<td>04</td>
</tr>
</tbody>
</table>
Prepayment of Escrow Item

Along with prepayments of interest, the buyer might have to fund escrow accounts that the lender maintains on their behalf to pay for certain items when they come due. Institutional lenders typically require an escrow fund be established if the loan-to-value (LTV) is greater than 80%. This fund covers payment of property taxes, hazard insurance, mortgage insurance, and community association fees. The buyer is required to deposit sufficient funds to ensure the escrow account has enough money to pay the aforementioned costs as they come due. This is not a proration. It is a prepayment. The amount of the prepayment varies depending on the time of year the loan is closed.

The escrow funds for prepayment of property taxes is collected as follows:

- **Escrow of the seller’s share of the taxes at closing.** The seller’s share of the taxes up until closing must be escrowed so that the funds exist for later payment of the tax bill by the lender. The buyer must deposit this amount in escrow at closing. However, this is really a “wash” to the buyer since the taxes owed by the seller will be credited to the buyer for the property tax proration shown earlier in this chapter.

- **Additional escrow required by the lender.** Lenders often want buyers to pay three months of taxes in advance to insure that there is money to pay the taxes if the buyer does not make their monthly payments. For other items, two months in advance is usually enough. The buyer must deposit this amount in escrow at closing.

- **Ongoing monthly escrow of buyer’s share of the taxes.** Once the escrow fund is established at closing, the lender adds 1/12 of the annual expense for each escrow item to the buyer’s monthly mortgage payment. These are called *budget mortgages*.

**Example:** Calculating prepayment of three months property tax for escrow.

The estimated property taxes for the year are $2,526.00, and the closing is on May 12th. The lender wants an extra three months of taxes for the startup escrow account. What is the amount that the buyer must provide as a deposit into the escrow account on the day of closing?

**Step 1**
Calculate the number of months for which the buyer needs to deposit property tax prepayments.

\[
5 \text{ May is the } 5^{th} \text{ month of the year (January through May)} \\
+ 3 \text{ Number of months required by lender} \\
8 \text{ Number of months of property tax prepayments}
\]

**Step 2**
Calculate the monthly property tax rate.

\[
$2,526 \text{ estimated property tax } \div 12 \text{ months } = $210.50 \text{ per month}
\]

**Note:** Starting with the first mortgage payment, the buyer’s monthly mortgage payment will include an additional $210.50 per month for the escrow of property tax.
Step 3 Calculate the amount of property taxes the buyer must deposit into escrow for the lender.

8 Number of months of property tax payments
3 $210.50 Monthly property tax rate
6 $1,684.00 Amount of property tax to deposit into escrow

Step 4 Entries on the Closing Disclosure: Debit the buyer $1,684.00. This is a single entry on page 2 in Section F. Prepaid, under Other Costs.

Other Costs

<table>
<thead>
<tr>
<th>E. Taxes and Other Government Fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>01 Recording Fees</td>
</tr>
<tr>
<td>02</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>F. Prep dives</th>
</tr>
</thead>
<tbody>
<tr>
<td>03 Homeowner’s Insurance Premium (mo.)</td>
</tr>
<tr>
<td>04 Mortgage Insurance Premium (mo.)</td>
</tr>
<tr>
<td>05 Prepaid Interest (per day from to)</td>
</tr>
<tr>
<td>06 Property Taxes (8 mo.)</td>
</tr>
<tr>
<td>07</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>G. Initial Escrow Payment at Closing</th>
</tr>
</thead>
<tbody>
<tr>
<td>01 Homeowner’s Insurance</td>
</tr>
<tr>
<td>02 Mortgage Insurance</td>
</tr>
<tr>
<td>03 Property Taxes</td>
</tr>
<tr>
<td>04</td>
</tr>
</tbody>
</table>

Note: As discussed earlier in this chapter, the property tax is prorated. So there will also be a seller debit and a buyer credit for the seller’s share of the taxes from January 1st to May 12th, since that portion of the taxes are the seller’s responsibility.

State Transfer Taxes

The State of Florida generates revenue from all real property transfers by taxing new deeds and taxing all new loan documents, such as mortgage liens and mortgage notes.

Originally, buyers had to purchase stamps, similar to postage stamps, which were attached to the document to show that the appropriate tax had been paid. Today, a rubber stamp is used to imprint on the document that the tax has been paid, and the amount of the tax is written in the space provided. Even though actual stamps are no longer purchased, the tax is still referred to as a stamp tax. However, today, we speak in terms of units rather than stamps.

There are three types of taxes:

- **Stamp tax on a new deed.** Before a deed can be recorded in the public records, documentary stamps must be purchased and affixed to the deed. Stamps are purchased from the clerk of the circuit court, usually when the deed is presented for recordation. Currently, the tax on the deed is calculated at the rate of $.70 per $100 of value, or fractional part thereof, based on the sales price of the property (the tax rate in Dade County only is $.60 rather than $.70). In the absence of any agreement to the contrary, the seller is responsible for the payment of this tax.
- **Intangible tax on new mortgage liens.** The state intangible tax on mortgages is paid on all new mortgages only. The state intangible tax on a mortgage is calculated at the rate of 2 mills (.002) on the total amount of a new mortgage. The tax is not payable when a mortgage is being assumed or title to the property is taken *subject to* the mortgage. The buyer usually pays this tax. The tax is collected when mortgage documents are recorded in the public record.

- **Stamp tax on new notes.** The state documentary stamp tax on a promissory note is calculated at the rate of $0.35 per $100 or fractional part thereof on the total amount of the note. The state documentary stamp tax on the note is paid on both new and assumed notes. This tax is not payable if title is taken *subject to* the mortgage. The buyer usually pays this tax.

<table>
<thead>
<tr>
<th>TAXES PAYABLE IN REAL ESTATE CLOSINGS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Usually Paid by:</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Tax rate</td>
</tr>
<tr>
<td>Applies when purchased for cash</td>
</tr>
<tr>
<td>Purchased subject to a mortgage</td>
</tr>
<tr>
<td>Purchased with an assumed loan</td>
</tr>
<tr>
<td>Purchased with a new loan</td>
</tr>
</tbody>
</table>

* This tax is calculated at the rate of .60/$100 or fractional part thereof in Miami-Dade County only.

It is important to note that the taxes are due only on new documents at the time they are created, and the taxes are never charged twice for the same document.

When the buyer assumes an existing loan, they sign a new note to take over the responsibility for the debt. Signing this new note incurs the tax on new notes because a new note was created, but not an intangible tax because no new lien was created and given to the lender. The lien the lender received when the original loan was created is still valid and does not have to be replaced. The lien is on the property, not on the person who borrowed the money.

However, if the buyer buys the property subject to the existing loan, no new documents are created. Therefore, no new intangible or tax on new note taxes are incurred.

**State Documentary Stamp Tax on Deed**

The transfer tax on real property is $0.70 per $100 of value or fraction thereof. The formula is sale price divided by $100 to get the number of units. Since the law states "or fraction thereof," you must round the number of units up to the next whole unit (never round down), and then multiply by $0.70.

**Note:** In Miami-Dade County only, per Florida legislative mandate, this tax is $0.60 per whole unit for the transfer of a single-family residence, and a rate of $0.60 plus $0.45 surtax for transfers of any real property other than a single-family residence.
Example: Calculating documentary stamp tax on deed.

If the buyer purchases a home for $148,610 in Broward County, what is the documentary stamp tax on the deed amount that they owe?

1. Calculate the number of tax units.

   $148,610 sales price ÷ $100 = 1,486.1 units

2. Round up to the next whole number, if applicable.

   Since the division resulted in a decimal, round up to the nearest whole unit. In this case, round up to 1,487 whole units.

3. Calculate the documentary stamp tax amount on the deed.

   1,487  Whole units
   x  $0.70  Transfer tax rate
   $1,040.90  Documentary stamp tax amount on deed

4. Entries on the Closing Disclosure: Debit the seller $1,040.90

   This is a single entry on page 2 in section Other Costs, E. Taxes and Other Government Fees. (See “Example: Calculating documentary stamp tax on a new mortgage, Step 4” for the completed form example.)

Intangible Tax on New Mortgage Liens

The tax on all new mortgage liens is 2 Mills, or .002 times any new mortgage amount.

Note: You do not need to divide by $100 or rounding up. This is a straight multiplication calculation.

Example: Calculating intangible tax on a new mortgage lien.

If the buyer receives a mortgage for $276,000, what is the intangible tax amount on their new mortgage?

1. Calculate the intangible tax amount

   $276,000  New mortgage amount
   x  .002  Intangible tax rate
   $552.00  Intangible amount on new mortgage

2. Entries on the Closing Disclosure: Debit the buyer $552.00

   This is a single entry on page 2 in section Other Costs, E. Taxes and Other Government Fees. (See “Example: Calculating documentary stamp tax on a new mortgage, Step 4” for the completed form example.)

Documentary Stamp Tax on New Mortgage Notes

This tax applies to all new loans and all assumed loans. Remember, when a buyer assumes a loan, they sign a new note. Loans can only be assumed if the original loan...
does not have a due-on-sale clause, or when the lender grants permission for the buyer
to assume the existing loan.

This calculation is similar to the tax on new deeds. The only difference is the tax
amount is $0.35 per $100 or fraction thereof.

Example: Calculating documentary stamp tax on a new mortgage.

If the buyer receives a mortgage for $276,610, what is the documentary stamp
tax on their new mortgage?

**Step 1** Calculate the number of tax units.

$276,610 new mortgage amount ÷ $100 = 2,766.1 units

**Step 2** Round up to the next whole number, if applicable.

Since the division resulted in a decimal, round up to the nearest whole
unit. In this case, round up to 2,767 whole units

**Step 3** Calculate the documentary stamp tax.

\[
\text{2,767 Whole units} \times \frac{\$0.35}{\text{Transfer tax rate on new note}} = \frac{\$968.45}{\text{Documentary stamp tax amount on new note}}
\]

**Step 4** Entries on the Closing Disclosure: Debit the buyer $968.45

This is a single entry on page 2 in Section E. Taxes and Other
Government Fees, shown below with all of the state transfer taxes from
the previous examples.

<table>
<thead>
<tr>
<th>Other Costs</th>
<th>E. Taxes and Other Government Fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>01 Recording Fees</td>
<td>Deed: $968.45 Mortgage: $552.00</td>
</tr>
<tr>
<td>02</td>
<td>At Closing Before Closing</td>
</tr>
</tbody>
</table>

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<thead>
<tr>
<th></th>
<th>Borrower-Paid</th>
<th>Seller-Paid</th>
<th>Paid by Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>At Closing</td>
<td>Before Closing</td>
<td>At Closing</td>
<td>Before Closing</td>
</tr>
<tr>
<td>$1,520.45</td>
<td></td>
<td>$1,040.90</td>
<td></td>
</tr>
</tbody>
</table>

Remember, if the buyer purchases the property subject to the existing mortgage and
there is a lien remaining on the property, then this tax does not apply since no new
documents were created.

**Review the Closing Disclosure**

As discussed earlier, RESPA requires lenders to provide borrowers with a completed
Closing Disclosure form at least three days prior to closing. With recent changes,
lenders will now prepare the Closing Disclosure, whereas in the past, the HUD-1 was
prepared by the closing agent. As a result, closings may take longer, and more lead-time
for money transfers will need to be scheduled.

If you think there is something amiss when you review the Closing Disclosure, you
should call the lender to review any suspected errors and/or omissions for possible
correction. The lender will determine if any corrections are necessary according to
applicable laws and lender instructions.
If you represent the seller, you should compare the numbers on the seller’s side of the Closing Disclosure with the initial estimate of the seller’s net sale proceeds and prepare to explain any differences to them.

Once you have verified the information on the Closing Disclosure, you should meet with your buyer or seller to review it with them. It is considered unprofessional to allow your client to go to a closing without having seen the Closing Disclosure beforehand. Many documents need to be signed at the closing. Closings are for signing, not for reading.

Your job is to review and explain the numbers to them. This is perhaps the largest transaction of their lives and they may view it with trepidation. They need to be assured that the numbers are correct and that you, their professional, are looking out for their interest. Your buyer or seller will have questions about the Closing Disclosure. You may be able to reduce their stress by answering their questions professionally and satisfactorily. If you can’t answer the questions, their level of anxiety may rise. This is the time to know what you are talking about and show your professionalism and level of expertise.

Buyers are typically concerned with the amount of funds necessary to close, and sellers are usually concerned with the amount of funds they will receive at closing. Find these numbers in advance and make sure that you can explain each of the numbers. The buyer and seller will look for their respective numbers at the closing. If the number they see is the number they expect, the signing will begin and the closing will go smoothly. If not, there could be some delays.

**Pre-Closing (Walk-Through) Inspections**

Prior to the settlement, you should schedule and coordinate a pre-closing (or walk-through) inspection of the property with the buyer. The purpose of this pre-closing inspection is fivefold:

1. To confirm that the seller has vacated the property, and that it is ready for occupancy

2. To determine that the seller did not damage the property during their move

3. To verify that any personal property included in the sale and purchase contract is there

4. To make sure that repairs and/or maintenance that the sellers may have agreed to perform before the settlement have been completed

5. To ensure that the property has been maintained in the same condition as it was on the effective date of the sales contract, allowing for any reasonable wear and tear during the interim period

Remember, you are not an inspector. If any work needs to be inspected, it should be done prior to the walk-through by a qualified inspector. Do not assume responsibility for this. It is recommended that you have the buyer sign a pre-closing inspection clearance form that states their satisfaction with the above items on that date. This is a good opportunity to retrieve your lock-box so you will have a key to deliver to the buyer at the closing.
Closing Day

When all of the pre-closing tasks have been completed properly, the closing may proceed. There are actually two closings taking place: the buyer closes on their loan, and the buyer and seller close on title to the property.

At the actual closing, each party signs all of the respective documents. If any financing is involved, the closing agent forwards the borrower-signed documents to the lender for approval. Once the closing agent receives the lender's approval, they may disburse the funds in accordance with the Closing Disclosure.

At the closing, you should obtain a fully signed Closing Disclosure and the brokerage sales commission checks from the closing agent to be delivered to your employing broker. Check your company policy and procedures manual regarding what copies to make and what you need to close the file on this transaction. Any keys you may have to the property should be given to the buyer.

AFTER THE CLOSING

Your post-closing activities may include:

- Change the status of the listing in the MLS from Pending to Closed.

- Arrange for the removal of your sign and your lock-box, unless you did that during the walk-through inspection.

- Write a thank you note to your client and schedule a follow-up visit. The purpose of the visit is to ensure customer satisfaction, offer help in any matters related to the sale, and receive feedback on your services. Remember to ask that they refer friends who need real estate services to you.

After the closing day has passed and everything is in order, remember to check through the pending file for this transaction to be sure that it contains copies of all documents created throughout this process, including the signed Closing Disclosure form and any other applicable documents from the closing. If your broker's office policy requires that you fill out any final forms, complete that paperwork, and close the file. Remember that Florida requires all brokers to maintain their transaction files for at least five years and for at least two years after the end of any litigation, whichever occurs later.
CHAPTER 9 REVIEW QUESTIONS

1. A _____________ is important to schedule, track, and make sure all necessary items are completed on time. The checklist should include items such as changing the _____ status, submitting the _____________ to the lender, ordering any _____________, and tracking any _____________ that need to be cleared.

2. A general home inspection concentrates on the following area of the home: ________ elements, ________ evaluation, ________ and ________, ________ systems and components, ________, ________, ________, and ________ and storage.

3. As part of the loan application and approval process, lenders will order a _____________, which consists of three parts: a ________, a physical ________, and a _____________ search.

4. Many brokerage firms do not maintain an escrow account; instead, they opt to use the escrow account of a _____________ or an _____________.

5. FREC rules require a sales associate to deliver any escrow deposit to the ________ prior to the close of business on the ________ business day. The broker is required to have the funds deposited prior to the close of business on the ________ business day following the ________ of the funds.

6. Whichever party pays for the _____________ chooses the escrow agent.

7. You need to help your buyer understand the three types of insurance that they will be dealing with during and after closing: ________, ________, and ________ insurance.

8. The standard property insurance policy generally includes four types of insurance coverage: coverage for the ________, ________ property, additional ________ while repair work is done, and ________ protection.

9. The lender usually requires the _____________ to pay for the lender’s title insurance policy at the loan closing as a requirement to obtain the desired financing.

10. Information required by the closing agent includes: a copy of the seller’s ________, previous ________ policy and property ________, all existing ________ for outstanding financing, identification and contact information for all parties, copies of the ________ and ________, and brokerage ________ and ________ structure.

11. To speed up the closing process and disbursement of funds, closing agents need ________ funds in their account, including the buyer’s ________, any secondary deposits, the new ________, and the buyer’s balance to close.

12. The ________ section of the Closing Disclosure specifies the adjustments between the two parties for items either paid by the seller in advance or unpaid by the seller at settlement, based on ownership days.

13. ________ entries on the Closing Disclosure are expenses that only one party pays to an outside party, as in a debit to a lender. ________ entries are expenses between the two parties as a credit and a debit.

14. If the community association monthly fee is $250.00 and the closing date is August 23rd, the prorated amount of $ ________ is a debit to the ________ and a credit to the ________.

15. ________ requires lenders to provide the Closing Disclosure to the borrower at least ________ days prior to closing. The _____________ is held liable for the accuracy and timing of the buyer’s Closing Disclosure.
CHAPTER 9 PRACTICE EXAM

1. The estimated property tax for a home that is closing on March 11th is $1,414.63 per year. How would the prorated taxes appear on the Closing Disclosure if the day of closing is paid by the buyer?
   a. Debit the buyer $267.42; credit the seller $267.42
   b. Debit the seller $1,147.21; credit the buyer $1,147.21
   c. Debit the seller $267.42; credit the buyer $267.42
   d. Debit the buyer $1,147.21; credit the seller $1,147.21

2. Which of the following is NOT a purpose of a pre-closing inspection?
   a. To determine that a seller has not damaged the property during his or her move
   b. To confirm that the seller has vacated the property
   c. To confirm that any personal property that is included in the purchase is present
   d. To determine that the lot number, mailing address and/or legal property description is accurate

3. What is the intangible tax rate on all new mortgage liens?
   a. .004 times any new mortgage amount
   b. .022 times any new mortgage amount
   c. .002 times any new mortgage amount
   d. .02 times any new mortgage amount

4. Which statement is true regarding the owner’s title insurance policy?
   a. It is transferable.
   b. It is recorded with the deed.
   c. It must be renewed every five years.
   d. It is not transferable.

5. A buyer may want a home inspection, or it may be required by the lender. Which statement is NOT correct?
   a. It is best to choose a home inspector who also performs repairs, since they can quickly be hired to resolve any problems.
   b. Home inspectors must be licensed by the Florida Department of Business and Professional Regulation (DBPR).
   c. Inspection is limited to what can be easily observed and may not detect problems that are inside walls or under floors.
   d. A standard home inspection may not include termite or mold inspection, which requires a separately specially-licensed inspector.

6. What type of insurance coverage allows an injured person to submit medical bills to the property owner’s insurance company?
   a. Coverage for personal property
   b. Coverage for the structure
   c. Coverage for treatment
   d. Coverage for liability protection

7. How often is a buyer required to prepay the mortgage loan interest?
   a. Monthly, over the life of the loan
   b. Quarterly, over the life of the loan
   c. Yearly, over the life of the loan
   d. One time, at closing

8. Which type of loan agreement between the seller and the buyer allows for the least amount of liability for the buyer?
   a. Assumption of
   b. Subject to
   c. Secondary mortgage
   d. Co-sign mortgage

9. How many days should you use to determine the amount of buyer credit when prorating rental income?
   a. The total number of days for the month prior to closing
   b. The total number of days for the closing month
   c. The actual number of days that the buyer owns the property for the closing month
   d. The actual number of days that the seller owns the property for the closing month
10. **What amount is charged for the Florida State Documentary Stamp Tax on a deed (outside of Miami-Dade county)?**
   a. $0.35 per $100 of value or fraction thereof.
   b. $0.70 per $100 of value or fraction thereof.
   c. $0.70 per $1000 of value or fraction thereof.
   d. $0.002 per $100.

11. **Which statement is true regarding the tax year in Florida?**
   a. It is the calendar year and taxes are paid in arrears.
   b. It starts April 15th and taxes are paid in arrears.
   c. It starts April 15th and taxes are paid in advance.
   d. It starts November 1st and taxes are paid in advance.

12. **What is the purpose of the Real Estate Settlement Procedures Act (RESPA)?**
   a. To inform consumers regarding the real estate licensee’s relationship and duties to the buyer and/or seller.
   b. To protect borrowers against fraudulent lending practices with seller-financed loans.
   c. To protect borrowers from abusive loan settlement costs and provide borrowers with helpful information on loan costs.
   d. To assist sellers and buyers with resolution of escrow disputes.

13. If the appraiser’s opinion of value is lower than the contracted sales price, you and the seller can take actions that could resolve a resulting financing problem. Which action would be least likely to help resolve the problem?
   a. Provide additional comparable and pending sales data to the appraiser that supports a higher sales price.
   b. Ask the seller or the lender to hire a different appraiser to try to get a significant change in the appraisal results.
   c. Negotiate a lower sales price with the seller to match the appraisal value.
   d. Negotiate with the seller to correct the problems or deficiencies with the property that caused the low appraisal.

14. **What is the purpose of the Closing Disclosure?**
   a. To designate which party pays for the title insurance.
   b. To assign a closing date.
   c. To prorate expenses between buyers and sellers.
   d. To include all documents to be signed at closing.

15. **How much is charged for the stamp tax on the deed for real property that is sold for $210,000 in Palm Beach County?**
   a. $735
   b. $420
   c. $7,350
   d. $1,470
CHAPTER

FORECLOSURES, SHORT SALES, AND AUCTIONS

OVERVIEW

Lenders take certain risks when they issue mortgage loans to borrowers. One of the most important risks in making a mortgage loan is that the borrower will default on the note in some way. When this happens, the lender may not receive the expected mortgage payments.

A mortgage default can result from any breach of the mortgage contract. The most common default is the failure to meet an installment payment of the interest and principal on the note. Default can also occur if a homeowner fails to pay taxes when they are due or neglects to pay hazard insurance premiums.

Most loan agreements stipulate the penalties that will occur if the borrower defaults. The most common penalty is the foreclosure of the property by the lender. Many lenders, however, prefer to avoid foreclosure if possible, so they will consider options. In this chapter, we discuss the foreclosure process, as well as the alternative a lender might consider to avoid foreclosure.

OBJECTIVES

After completing this chapter, you should be able to do all of the following:

- List and define several alternatives to foreclosure
- Discuss the deed in lieu of foreclosure
- Explain how to handle a short sale transaction
- Describe the foreclosure process
- Discuss the three types of auctions and common auction terms

FORECLOSURE ALTERNATIVES

Even though most mortgage contracts outline penalties that occur for any breach of contract, many lenders prefer to follow a procedure that prevents a foreclosure. Before considering any foreclosure action, a lender considers the amount of the borrower’s equity, the state of the current real estate market, and the position of any other lien holders. The lender also examines what caused the defaulting action and finds out the borrower’s attitude regarding feasible ways to cure the default.

The word *workout* is used to convey the activities that a lender undertakes to deal with a borrower who is having financial trouble. Often the lender and borrower will come to an agreement to specify the rules they will follow during the workout period. The lender usually agrees to avoid taking legal action. In exchange, the borrower agrees to acknowledge their financial problems and consent to certain conditions that will help alleviate the problem, such as giving the lender periodic and detailed financial statements or agreeing to deposit rents from a rental property into a special account from which they can withdraw only with the lender’s approval.

The alternatives that a lender considers in a workout include:

- Forbearance or moratorium
- Restructuring the mortgage loan
- Transferring the mortgage to a new owner
- Deed in lieu of foreclosure
- Short sale transaction
Forbearance or Moratorium

The most common reason for default is failure to make the mortgage payments. Borrowers can have difficulty making payments for a variety of reasons. Among other things, a borrower could lose their job, lose pay due to an extended illness or injury, suffer a personal tragedy, or overextend their credit by running up credit cards.

After a lender considers the possible causes for the borrower’s failure to make the payments, the lender may decide to enter into an informal agreement with them. For instance, if the borrower cannot make all of the monthly mortgage payments, the lender may choose to waive the payments for the short term or even forgive all or some of the payments entirely. These waivers are known as forbearance or moratoriums.

In these circumstances, the lender may allow the borrower to retain possession of the property in return for meeting some monthly payments, which may or may not include payments towards the principal.

If the lender and the borrower can reach such an informal agreement, the lender will adjust the payment amount to meet an amount that the borrower can afford. Then, if their financial condition improves, the lender can opt to have them resume the originally scheduled payment amount.

The four common types of forbearance are listed below.

- Waiver of principal payments. Waiver of principal payments is when the lender allows the delinquent borrower to suspend the payment of the principal and just pay the interest. Sometimes the lender will permit the borrower to skip the entire monthly payment of principal and interest. Any suspended payments are added to the principal, which results in higher payments later in the loan term.

- Deferred interest. The deferred interest type is when the lender suspends the borrower’s interest payments. The interest is not forgotten but added to the principal, similar to a negative amortization loan. This would be especially helpful to a person whose monthly payments are almost all interest, either because of a high interest loan or because it is a newer loan.

- Partial payments. The partial payments type of forbearance is when the lender agrees to accept a partial payment of the mortgage. If the situation is determined to be temporary, such as unemployment or disability, the lender may be willing to accept partial payments for a period of time with the assurance that the borrower will add extra money per month at a later time to make up for the delinquency.

- Prepayments. In the case of forbearance, the prepayment type is when the lender reapplies prepayments that were credited to the principal in the past. In some situations, the borrower sold off part of the property and used the income from that sale to cure the deficiency.

Restructure the Mortgage Loan

Lenders can restructure a loan in several ways. To restructure the mortgage loan involves lower interest rates, accruals of interest, or extended maturity dates. If the borrower is not personally liable for the original loan, called a nonrecourse loan, the lender could decide to make the borrower personally liable as part of the loan restructuring agreement. This exposes the borrower to significantly more risk if the restructuring fails. The lender may also require a participation in the performance of the property as compensation for the willingness to restructure the loan. For instance, the lender could ask for a percentage of any increase in the income of the property over its current level.
Two popular forms of loan restructuring are:

- Recasting
- Extension agreements

**Recasting**

The form of a mortgage can change at any time for any number of reasons over the life of a real estate loan. The process of redesigning a loan is called recasting. A loan is most frequently recast by changing the terms, either temporarily or permanently. Lenders can change terms such as interest rate, amortization period, or payment amount to help ease the strain on the borrower. However, the lender must do this carefully so as not to run the risk of other liens taking priority over the recast loan. For instance, a lender could decide to take no action regarding a delinquency on a construction loan until the building sells, because the recasting of the loan might jeopardize the lien priorities.

**Extension Agreements**

In some cases, the borrower may want to extend the terms of the mortgage. The lender can do this by lengthening the amortization period for the remaining principal. However, before considering and agreeing to such an extension, the lender would investigate some issues.

- What is the current condition of the property? Has it been well maintained or does it show evidence of neglect?
- What is the status of any liens? Have liens been filed after the mortgage was recorded? If so, what would be the consequences of an extension?
- What is the status of any grantees who may have assumed the mortgage? Would the issue of an extension release the grantees from liability?

**Note:** If the borrower can refinance the loan with more favorable terms, it is probably not a good idea to apply for an extension agreement. However, the borrower should realize that refinancing could result in changes that are favorable to the lender, such as an increase in the interest rate.

**Transfer the Mortgage to a New Owner**

If the borrower cannot meet their monthly mortgage payments and are in danger of default, they may be able to find another person who can purchase the property and, either assume the mortgage, or take the property subject to the existing mortgage. A new buyer may be willing to accept this mortgage transfer if they think that the value of the property is more than the mortgage value.

In either case, the borrower (seller) retains personal liability for the debt. However, if they are on the brink of default and think that they will lose the property anyway, they may be willing to take the risk of a new purchaser being able to carry out the mortgage obligation. The risk with taking this approach is that the new buyer will default and the original borrower will regain responsibility for the debt yet again.
As we discussed in Chapter 8, any buyer who acquires a property subject to the existing loan does not have any personal liability for the debt. Therefore, the new purchaser can lose only the equity that they have invested in the property to purchase it. This investment could be very small, especially if the seller is facing foreclosure. In such circumstances, the new buyer doesn't have much to lose by taking a chance on the property. If it turns out to be a good investment, the new buyer will continue to make the mortgage payments. However, if the new buyer determines that the property will not be worth more than the mortgage debt within a reasonable time, they can discontinue making payments and let the seller have the property back.

Deed in Lieu of Foreclosure

When a borrower knows that they can no longer meet their mortgage obligation, they may attempt to sell the equity of the property to the lender. To save time and minimize the expense of a foreclosure, the lender may make or accept an offer to take the title to the property back from the borrower.

If both the borrower and the lender agree that the property is more valuable than the mortgage balance, the lender may consent to pay some money back to the borrower for their equity in the property. If the value of the property is less than the mortgage balance, the lender may still be willing to accept the title and release the borrower from the debt. This is called voluntary conveyance or giving deed in lieu of foreclosure. Lenders are usually willing to agree to this solution when the cost of a foreclosure is expected to exceed the loss.

In a deed in lieu of foreclosure situation, the title is usually transferred with a warranty or quitclaim deed from the borrower to the lender specifying that the borrower transfer all legal rights and interests in their real property to the lender in exchange for the avoidance of an actual foreclosure. It's important for the borrower to get this release to be sure that they are no longer bound under the note and mortgage. This is especially important in situations where the mortgage balance is more than the value of the property. Otherwise, the borrower may find that they still have an obligation to pay part of the mortgage note, even after they hand the title back to the lender.

Requirements

Among other requirements, the underlying loan must be secured by the real property being conveyed, both parties must act voluntarily and in good faith, and, in most cases, the total consideration in the settlement must be at least equal to the market value of the real property transferred. The defaulting borrower must voluntarily initiate a written offer to the lender of deed in lieu of foreclosure before the lender will be able to act upon it. The borrower must obtain the lender's consent for them to relinquish voluntarily the subject property as collateral to the lender. The lender may deny this permission, for instance, if the borrower has enough wealth, income, and assets to afford to pay the monthly mortgage payments. In addition, the local real estate market conditions will also weigh heavily upon a lender's approval and/or denial of deed in lieu of foreclosure, since lenders generally want cash rather than title to real property.

In fact, most lenders want the defaulting borrower to show that they have offered the real property for sale on the market for a certain number of days (usually not less than 90 days) at a reasonable asking price. In addition, the real-world complexities of most real property ownership having more than one lien on the property might also prevent the possibility of a deed in lieu of foreclosure from happening.
Benefits of a Deed in Lieu of Foreclosure

The benefits to the defaulting borrower to voluntarily offer the lender a deed in lieu of foreclosure include:

- Being released from most, or all, of the personal indebtedness
- Incurring a lesser impact on their credit rating than an actual foreclosure
- Being released from the responsibility of actually selling the property
- Avoiding any public notoriety associated with a judicial foreclosure
- Receiving perhaps more generous settlement terms than those at the end of a formal foreclosure process

The benefits to the lender include:

- The cost savings when compared to the dollar outlay of an inevitable judicial foreclosure proceeding
- A much quicker time required for a settlement
- Lower risk of loss due to any defaulting borrower’s revenge on the subject property, such as vandalism and theft

Legal Advice

Whenever you are dealing with a potentially defaulting borrower, you should always advise them to seek legal and tax advice in order to understand fully any settlement language. For instance, with a deed in lieu of foreclosure, the lender may, or may not, release the defaulting borrower from any deficiency balance that might occur after a final sale of the property. Due to this possibility, you should advise the defaulting borrower to seek legal counsel for a possible bankruptcy filing before a settlement. Depending on which type of bankruptcy the borrower files, part, or all of any deficiency judgment that would be an unsecured lien might be eliminated. However, any advantage to the borrower’s credit rating established by a deed in lieu of foreclosure will most likely be erased by such a bankruptcy filing.

Tax Consequences

If the lender does forgive the deficiency loan balance, the IRS may consider this forgiveness of debt to be income and therefore taxable to the borrower as a gift from the lender. Under federal law, a creditor is required to file Form 1099C Cancellation of Debt with the IRS whenever they forgive a loan balance greater than $600.

Under the Mortgage Forgiveness Debt Relief Act of 2007, tax relief was available only for certain principal residence acquisition and home improvement loans during a forgiveness window of 2007 through 2012. This window was recently extended to 2014. Therefore, some forgiveness of debt still might create a tax liability to a defaulting borrower.
Short Sale Transactions

A short sale transaction is a sale transaction in which a seller, confronted with the threat of a foreclosure, enters into a settlement agreement with the lender where the lender consents to a sales price for the property that is below the outstanding loan balance. In other words, the sale proceeds fall short of the amount owed to the lender.

You need to understand that short sale transactions can be time-consuming and difficult. One of the difficulties from the outset is that a lender typically requires at least one, and sometimes more than one, bona fide offer to purchase from a buyer before the lender will even consider giving consent to a short sale settlement. In addition, the lender will reveal what amount of sale proceeds is acceptable at such a short sale settlement only after they have given consent. Not knowing this information in advance can be very frustrating for all of the parties involved in a short sale. It is common for selling brokers to include language in the sale and purchase contract that states to the effect that, "Buyer understands and agrees that acceptance of this offer to purchase and contract is subject to third-party lender approval within 120 days."

Requirements

As with a deed in lieu of foreclosure situation, the lender in a short sale transaction generally requires that the real property has been offered for sale on the market for a certain number of days at a reasonable price in order for the lender to feel confident that the short sale offers being presented are legitimate offers from legitimate buyers in that real estate market. The lender will want to qualify the property value with either a broker price opinion (BPO), an actual appraisal, or both.

A lender may hire a real estate professional to perform a BPO to help determine the selling price of the property since the licensee typically has knowledge of the local market. The licensee will be asked to take photos of the property and complete a BPO report form provided by the lender. The report includes a neighborhood analysis of comparable properties along with local and regional market information. Factors that will affect the price of the property in a BPO report are the values of similar surrounding properties, sales trends in the neighborhood, and the amount of repair needed to put the property up for sale. BPOs are less thorough than an appraisal, but require more analysis than a basic CMA.

The fact that real property might have more than one lien against it may prevent the possibility of a short sale transaction, since junior lien holders do not have any incentive to agree to a short sale transaction settlement if there is nothing in it for them. It is possible for any one creditor to refuse to reduce and release its respective lien and, therefore, stop a short sale transaction from taking place. In addition, if a lender has mortgage insurance on the loan, then that insurer will likely become a party to the negotiations because the insurer will be requested to pay out a claim on the lender's loss.

Please note, though, that just because a property is listed with short sale transaction terms does not mean that the lender will agree to the short sale even after the seller has accepted a sale and purchase offer from a buyer. A lender will insist upon qualifying a seller for a possible short sale transaction and not all sellers will qualify. For example, most lenders require not only that a short sale seller have missed multiple payments (with a negative impact upon that seller's credit rating) but that a short sale seller show financial hardship. If no financial hardship exists, then it probably makes more sense to a lender to foreclose and obtain a deficiency judgment against that defaulting borrower's other property, income, and assets. In such a case, you should advise the defaulting
borrower to seek legal counsel for a possible filing of bankruptcy before a closing settlement. Depending on which type of bankruptcy the borrower files, part or all of any deficiency judgment that would be an unsecured lien might be eliminated. However, similar to our discussion regarding a deed in lieu of foreclosure, any advantage to a defaulting borrower’s credit rating established by having a short sale transaction will most likely be erased by such a bankruptcy filing.

Benefits of a Short Sale

The benefits of a short sale to the seller include:

- Being released from most, or all, of the personal indebtedness
- Incurring a lesser impact on their credit rating than an actual foreclosure
- Avoiding any public notoriety associated with a judicial foreclosure
- Receiving perhaps more generous settlement terms than those at the end of a formal foreclosure process

The benefits of a short sale to a lender include:

- The cost savings when compared to the dollar outlay of an inevitable judicial foreclosure proceeding
- Avoidance of the responsibility of actually selling the property
- Lower risk of loss due to any defaulting borrower’s revenge on the subject property, such as vandalism and theft

Establishing Financial Hardship

As we mentioned in the previous section, it is necessary for the seller to establish that they have a hardship, which makes it unrealistic or exceedingly impractical for them to keep the property. Generally, lenders focus on and require changed financial circumstances.

Changed financial circumstances include, but are not limited to, the following:

- Job loss
- Unexpected or unusual medical bills
- Death of an owner
- Natural disasters
- Divorce
- Disability
- Extended military service for a reservist (in some cases)

The seller needs to write a letter to the lender to explain their changed financial circumstances. It is important for you to help the seller show a connection between the hardship and the need to sell. A seller who has lost a job and has a problem making a mortgage payment is obvious. However, if an illness requires the family to move closer to a specialized medical facility, regardless of financial hardship, the homeowner must move. Declining property values alone do not constitute a hardship.
The seller’s hardship letter should describe in detail the reasons why the short sale is necessary based on their situation and be as convincing as possible in their explanation as to why they cannot go on with making their payments. The lender can accept or reject a short sale based on this letter. The seller should state persuasive reasons and they must be honest and frank in their disclosures.

You can help the seller by including supporting material including:

- If the seller lost a job, include the termination letter.
- If there are medical bills, summarize them.
- If the situation is caused by illness or disability, have them explain how that has made it impossible for them to keep the property.
- If the seller has tax issues, have them describe them and offer proof.
- If the cause was damage due to a natural disaster that was not covered by insurance, have the seller provide evidence of the damage and the denial of the claim.

**Short Sale Documentation**

If the seller’s lender uses a formal short sale application, it is critical for the seller to complete it as soon as possible. This can be a very embarrassing time for the seller, and your empathy is essential. You should reassure the seller they are not alone. You should also prepare them for what is to come and make sure that they are willing to do what is necessary.

You and the seller should put together a packet of documentation to provide to the lender. The packet includes:

- Listing agreement
- Paycheck stubs for the last two months
- Federal tax returns for the last two years
- Current tri-merged (three-bureau) credit report
- Current financial statement that shows their income, assets, liabilities, and expenses
- Your well-prepared market analysis that describes the current market conditions and trends in the immediate area of the property
- The BPO (You can offer this as an additional opinion and not as a replacement for the one the creditor will order.)
- A letter from you in which you explain in detail why the short sale is a good business decision for the lender
- Your contact information
Short Sale Package

As we mentioned earlier, it is important that the lender know that you and the seller have done everything possible to sell the house at the highest price. You should include descriptions of your marketing efforts in the short sale package. Once the seller has received and accepted an offer, it’s time to present the package to the lender.

The short sale package should include:

- The packet of short sale documentation (described above)
- The seller’s hardship letter (described earlier)
- An explanation of why the short sale is needed and desirable from the lenders point of view
- A copy of the accepted offer
- A pre-approval letter from the buyer’s lender (Evidence that the buyer has the cash for the down payment and closing costs would be very helpful if it’s available.)
- A completed loan application from the buyer
- A copy of the escrow instructions, along with the name of the person handling the escrow
- The preliminary title report, if it applies
- An estimated Closing Disclosure prepared by a certified escrow officer. It is critical for the estimate to be as complete and accurate as possible. The lender may refer to the closing statement in the approval or rejection.

Short Sale Transaction Guidelines

Although it should be clear that in a short sale transaction you must abide by all of the same laws and rules that you must comply with in a regular sales transaction, a few key points are worth emphasizing:

- Manage the expectations of the seller and the buyer from the outset.
- Educate the seller and the buyer about this unpredictable process.
- Clearly define your role in the short sale proceedings.
- If you are a transaction broker, obtain the seller’s written permission to reveal the motivation of the seller for selling (e.g., short sale, avoid foreclosure, distressed sale, etc.) up front in the Listing Contract (and possibly in a completed MLS feature sheet) to avoid violation of limited confidentiality. [F.S. 475.278(2)(f)]
- Complete all of the terms of any offers to sale and purchase contracts with the proper addenda attached based upon the needs of that transaction.
• Make the running time of all time and dates to be effective upon lender approval of the short sale.

• When you are listing a property with short sale terms, be careful about setting the listing price unreasonably low. As a listing broker, a transaction broker, or single agent, you must act with skill, care, and diligence in the transaction. This means that you should educate the seller about this concern and then document how you arrived at a reasonable listing price with the seller. [F.S. 475.278(2)(c) and (3)(a)(7)].

• Advise the seller to talk with an attorney and tax professional about the potential legal and tax consequences in a short sale.

• Refer a party to a short sale transaction to the Florida Bar Lawyer Referral Service where lawyers charge clients a nominal amount for the initial half-hour office consultation.

For more information about the Florida Bar Lawyer Referral Service, please visit their Web site at www.floridabar.org.

• Tread very carefully when conducting legal negotiations between the seller’s lender and the seller. Although you could obtain written waiver language, or written permission, or a power of attorney document from a seller that permits you to act on the seller’s behalf, remember that practicing law without a license is a third degree felony with serious punishments.

**FORECLOSURE PROCESS**

If the defaulting borrower’s lender does not approve a deed in lieu of foreclosure or short sale transaction, then foreclosure is the last option available. In general, once the borrower has missed payments on a certain number of monthly mortgage payments, the lender sends them a notice of default that not only alerts them of the default but also allows them time to catch up on payments, if possible to do so. If the borrower cannot correct the default, the lender will pursue foreclosure through judicial means. In Florida, foreclosure is always a court process. The lender’s foreclosure claim will be tried in the court without a jury.

The foreclosure process officially begins when the lender records a *lis pendens* (notice of lawsuit) and files the lawsuit against the defaulting borrower with the appropriate court where the property is located. The defaulting borrower receives a notice of this action and they must file an answer within a specified period. If the borrower does not respond, then the court makes a judgment against them and sets a date for a foreclosure auction of the property.

According to Florida foreclosure law, a *notice of sale* must be published for at least three consecutive weeks, the last such notice not less than five days prior to the sale.
This notice of sale includes all of the following information:

- The name, address, and telephone number of the contact person for information about the property
- The address of the property
- A legal description of the property
- A description of the property’s improvements (if any)
- The time and place of the foreclosure auction sale
- The times specified in the judgment
- The case title, number, and court in which the foreclosure lawsuit was filed
- The terms of the prospective sale

Whenever a legal advertisement, publication, or notice relating to a foreclosure proceeding is required to be placed in a newspaper, it is the responsibility of the lender, or the lender’s representative, to place the advertisement, publication, or notice. The petitioner, the petitioner's attorney, or the clerk of the court can place the ad or notice.

Florida foreclosure property auctions typically take place at 11 a.m. at the courthouse 30 days following the date a court judgment is filed. A winning bidder at the property auction is required to have 5% down payment immediately and the balance due by the end of that day. When the court receives full payment, the person who conducted the sale issues a Certificate of Sale to the new buyer.

It is not possible to obtain any injunction against a foreclosure sale from the court, unless, perhaps, there was an error in the court's foreclosure procedure. There is a ten-day period after the foreclosure sale in which the court reviews the sale to ensure that a fair price was paid. Then, the Certificate of Sale is recorded and legal title transfers to the new buyer. If, for some rare reason, the court would not confirm that sale, then another foreclosure auction sale date would be ordered by that court.

**Equitable Right of Redemption**

Every defaulting borrower in Florida has Equitable Right of Redemption. This means that a defaulting borrower can stop a foreclosure proceeding and get their property back if they legally obtain the money with which to pay the lien in full and all expenses. This right to redeem one’s property is in force right up until the foreclosure sale of the property at auction. Once the Certificate of Sale has been issued, there is no further right to redeem one’s property in Florida.

**Deficiency Judgment**

When a mortgage foreclosure sale does not produce sufficient funds to pay the loan in full, the lender can obtain a deficiency judgment in order to try, through legal means, to satisfy the outstanding balance from the borrower’s other property, income, and assets. Deficiency judgments are allowed in Florida. Consequently, if outstanding debt remains after the foreclosure auction sale, the lender will file a deficiency judgment.

As in the case of deed in lieu of foreclosure and short sale transactions, it might be possible for the borrower to mitigate part, or all, of a deficiency judgment balance by filing bankruptcy. The deficiency judgment balance would be considered an unsecured debt to that creditor.

The chapter of bankruptcy the borrower files determines what debts might be wiped clear. The borrower would be wise to consult with an attorney who is experienced in bankruptcy law in order to understand any resolutions and options that might be available.
Auctions

There are three major systems for real property auctions throughout the nation:

- Courthouse auctions
- Government auctions
- Private auctions

Courthouse Auctions

Courthouse auctions, as we just discussed in the foreclosure section, are involved with the enforcement of liens due to borrowers defaulting on items such as property taxes, mortgages, income taxes, or community association fees, and any other judicially required proceedings leading to actual auction of the real property for repayment of that debt.

Government Auctions

Government auctions deal with real property owned by various government agencies that sell the property acquired from defaulting borrowers. Such government agencies include HUD and VA. By government request, each agency has set up auction websites to facilitate the sale of this real property.

This has presented an excellent opportunity for real estate professionals to specialize in helping potential buyers submit bids in a complex website-bidding process that varies from agency to agency. Knowledgeable and agency-approved real estate professionals can earn very respectable sales commissions for their hard work.

Once the government agency accepts an offer to purchase, the process that follows resembles a regular market sales transaction. If the property has been priced properly, the period from initial listing to closing averages only a couple of months.

Private Auctions

Private auctions involve all types of real property sellers. These auctions can take place on auction websites or through traditional auction companies. The National Auction Association (NAA) promotes itself as the largest professional association advocating for the professionalism of the auction industry.

For more information about the National Auction Association (NAA), please visit their Web site at www.auctioneers.org.

The NAA provides education and designation programs for its members, who must abide by a code of ethics. A real estate professional who wishes to earn a commission for bringing a successful buyer to a private auction must first find out if the private auction entity will participate and cooperate with selling brokers before introducing a prospective bidder to the auction entity.
Private auction contracts are rather straightforward and most of the time they contain three basic terms:

- **"As is, where is" condition.** The contract language "as is, where is" means that what the buyer sees is what the buyer gets.

- **No contingencies.** The contract language that states no contingencies usually includes no financing contingencies, so the prospective buyers must be certain of their ability to actually follow through with such a purchase with no refunds on bid deposits due to lack of financing.

- **Closing within 30 days.** The contract language that stipulates closing within 30 days provides for expedient closings that avoid any back-and-forth negotiations typical in regular market sale transactions.

### Auction Industry Terms

You should be aware of and understand the following special terms and phrases that the auction industry uses:

- **Open outcry.** Open outcry is when the highest price is the only consideration with all bidders required to bid with identical other terms.

- **Sealed bid.** Sealed bid is when bids are submitted in writing and all bidders are asked to submit their best offer and bid price.

- **Sealed bid convertible.** Sealed bid convertible is when bids are initially submitted for private evaluation where it can be determined from the depth of the market (multiple desirable bids) whether to convert the offering into an open outcry auction.

- **Without reserve/absolute.** The without reserve/absolute auction is where the highest bidder wins regardless of the price in a final sale.

- **Minimum bid.** A minimum bid is set and the property will only be sold at a price equal to or greater than that minimum bid amount.

- **With reserve/no stated price.** The with reserve/no stated price is when the seller states no definite asking price and reserves the right to accept or reject the highest bid.

- **Buyer’s premium.** A fact that is unique to auctions is that a buyer can be charged a buyer’s premium, which is calculated as a percentage of the high bid price and then added to that high bid price to arrive at the total sales price the buyer must pay. This buyer’s premium will then offset any marketing and commission costs involved in the auction sale process.
CHAPTER 10 REVIEW QUESTIONS

1. After considering the causes for a borrower’s failure to make the payments, the lender may choose to waive or forgive some payments in an informal agreement referred to as a ____________ or _____________.

2. Lowering interest rates or extending maturity dates are examples of ________________ a loan.

3. A borrower in danger of default may find a new purchaser to carry out the mortgage obligation with a ________________ mortgage, where the original borrower (seller) retains personal liability for the debt. The buyer’s loan is a ________________ loan, in that they are not personally liable.

4. A ________________ is the process in which the lender agrees to take the equity of the property to save the time and expense of a foreclosure. In this case, the title is usually transferred with a ________________ or ________________ deed.

5. A ________________ takes place when the lender is willing to accept title to the property even though the value of the property is less than the loan balance. Lenders may agree to this when the cost of a ________________ would most likely exceed the loss.

6. With a deed in lieu of foreclosure, the lender may or may not release the defaulting borrower from any ________________ after the final sale of the property. You should advise the defaulting borrower to seek ________________ for a possible ________________ filing before a settlement.

7. In a ________________, the lender consents to a sales price for the subject property that is below the outstanding loan balance.

8. Not all sellers will qualify for a short sale. The seller must (1) have offered the property _______ for a specified number days, (2) missed ________________ with a negative impact on the seller’s ________________, and (3) convince the lender that they have a ________________.

9. To obtain consent to a short sale, the seller must write a ________________ letter explaining their ________________, detailing the reasons why the short sale is necessary.

10. If the lender does not approve a deed in lieu of foreclosure or short sale transaction, a _______ is the last option available. In this case, the lender sends a ________________ to the borrower to alert them and give them time to ________________, if possible.

11. The foreclosure process officially begins when the lender records a ________________ and files a lawsuit with the court where the property is located. Following the borrower’s lack of response to a notice of this action, a foreclosure auction date is set. A ________________ must be published for at least three consecutive weeks. Upon sale, the new buyer is issued a ________________.

12. A ________________ auction is involved with the enforcement of liens due to the borrowers’ default on items such as property taxes, mortgage, income taxes, or community association fees.

13. A ________________ auction deals with the sale of real property owned by government agencies.

14. A ________________ auction involves all types of real property sellers and can take place on auction websites or through traditional auction companies.

15. An ________________ auction is when the highest price is the only consideration, with all bidders required to bid with identical other terms.
CHAPTER 10 PRACTICE EXAM

1. What process allows the borrower to sell the equity of the property to the lender?
   a. Deed in lieu of foreclosure
   b. Forbearance
   c. Recasting
   d. Short sale

2. Borrower John lost his job and was out of work for three months. His lender allowed John to miss two mortgage payments and agreed to add those payments to the back end of the loan. What is this type of moratorium known as?
   a. Partial payments
   b. Prepayments
   c. Waiver of payments
   d. Payment forgiveness

3. What does the IRS typically consider any mortgage loan forgiveness?
   a. Non-taxable income
   b. A business expense
   c. A deduction
   d. Taxable income

4. A mortgage lender has allowed a borrower to make a monthly payment that equals half of the original agreed upon terms of the note for the next four months. What type of forbearance arrangement is this?
   a. Waiver of payments
   b. Partial payments
   c. Diminished payments
   d. Prepayments

5. What is the term used for an auction that requires bidders to submit in writing their best offer and bid price?
   a. Unsealed bid
   b. Sealed bid
   c. Open outcry
   d. Minimum bid

6. Lenders can restructure a loan in several ways. Changing the interest rate is an example of which popular form of loan restructuring?
   a. Interest modification
   b. Deferred interest
   c. Recasting
   d. Extension agreement

7. When does the foreclosure process officially begin?
   a. When the lender records a lis pendens
   b. When the court makes a judgment against the borrower
   c. When the date for the foreclosure auction is set
   d. When the borrower stops making payments

8. Which of the following is NOT a benefit to the mortgage lender when they agree to a deed in lieu of foreclosure?
   a. Avoids having to sell the property
   b. Less expensive than a judicial foreclosure
   c. Faster settlement time
   d. A lower risk of property loss

9. Which of the following statements best defines a short sale?
   a. Any sale of real estate that falls short of generating a profit for the borrower
   b. Any sale of real estate that generates proceeds that are less than the amount owed to the lender
   c. Any sale of real estate that occurs before all terms of the mortgage agreement are met
   d. Any sale of real estate that results when the borrower stops making loan payments

10. Which of the following statements best defines a deficiency judgment?
    a. A legal action against a borrower whose mortgage payments are late
    b. A legal action against a buyer who fails to produce the agreed upon loan down payment at closing
    c. A notice of court action resulting from the filing of a lis pendens against a defaulting borrower
    d. A legal action against a borrower whose mortgage foreclosure sale did not produce sufficient funds to pay the loan in full
11. Which condition is NOT conducive to a short sale?
   a. Seller misses multiple payments with negative impact on their credit rating
   b. Establish seller’s financial hardship
   c. Property has one or more outstanding liens
   d. Property offered for sale at a reasonable price for a specified amount of time

12. Property owner Norm has been informed that a vacant lot he owns will be auctioned off for back taxes. What type of property auction will take place?
   a. Courthouse
   b. Government
   c. Private
   d. Closed

13. Which item would NOT generally be included in the documentation for a short sale package?
   a. Broker price opinion (BPO)
   b. Seller’s paycheck stubs
   c. Seller’s federal tax returns
   d. Seller’s personal profile, including photographs, family status, and age

14. What legal process is open to a delinquent mortgage borrower who wants to reclaim their property that is in the foreclosure process?
   a. Deed in lieu of foreclosure
   b. Equitable right of redemption
   c. Deficiency judgment
   d. Bankruptcy

15. Which condition is NOT generally part of a private auction contract?
   a. “As-is” condition of the property
   b. No contingencies
   c. No foreign buyers
   d. Closing with 30 days
Residential homeownership consists of an assortment of single- and multiple-family dwellings. As a real estate professional, you should understand the particulars of the sale and purchase of these types of homes. However, along with the familiar types of single-family residences, you will also deal with the more complex types of residential dwellings, particularly condominiums (condos), cooperatives (co-ops), and timeshares.

In addition to the issues that surround the purchase of a more typical residence, those who buy condos, co-ops, and timeshares also must deal with such concepts as condominium documents, homeowners' associations, common and limited-common elements, maintenance assessments, and special assessments. In addition, they will have to deal with complex financing and taxation issues.

Essentially, when a buyer purchases a condo, co-op, or timeshare unit, they will be living with other owners who made a similar purchase in the same building. Neighbors are separated by walls, floors, and ceilings. They are not on a physically separate piece of land in a physically separate building. Owners will share common elements, such as elevators, hallways, parking areas, and recreational facilities. These areas belong not to just one resident, but to all residents who own property in that building. Common elements are governed by rules and regulations to which all residents are bound. This is the nature of this type of living.

After completing this chapter, you should be able to do all of the following:

- Distinguish between the various types of community associations based on their characteristics
- Describe the laws, documents, and purchasing process associated with condominium ownership
- Describe the purchasing process, financial statements, and documents associated with cooperative ownership
- Describe the types of timeshare ownership and the disclosures required by Florida law
- Discuss the purpose and required disclosures for Homeowners' Associations (HOAs)
- Know when a Community Association Management (CAM) license is required and discuss the duties of a CAM

Ownership within a community association exists in a wide variety of developments from planned unit developments to mobile home parks. You should be knowledgeable about the four most common types, listed on the following page.
Types of Community Associations

Each type of community association is governed by a different Florida statute.

- Condominiums [F.S. 718]
- Cooperatives [F.S. 719]
- Timeshares [F.S. 721]
- Homeowners’ Associations [F.S. 720]

To read the applicable Florida statutes, please visit this Web site:
www.leg.state.fl.us/statutes

CONDOMINIUMS

Condominium ownership dates back to the passage of the National Housing Act in 1961 that legally recognized this type of real property ownership for the first time in the United States. A condominium is a building in which each owner has a percentage ownership of the entire property. Condominiums can be residential, commercial, or industrial, but in this chapter, we discuss residential condominiums.

Florida Condominium Law

Florida condominium law establishes that every condominium buyer has the right to obtain from the seller a copy of the following documents:

- Declaration of Condominium
- Articles of Incorporation
- Bylaws and Rules of Association
- Condominium Association’s Question and Answer Sheet
- Most Recent Financial Statements

Under Florida condominium law, the very first buyer from a developer has a 15-calendar-day rescission period, while every subsequent buyer has a 3-business-day rescission period. These rescission periods allow a condominium buyer to cancel the sales contract and receive the deposits back. The buyer is not required to give reason for the cancelation; however, they are required to provide timely cancelation within the rescission period. The rescission periods for buyer cancelation begin at the effective date of the sales contract or at the date of the buyer’s receipt of the above condominium documents, whichever is later. It is therefore very important for the selling broker to obtain proper documentation of these dates and times.

In addition, Florida law now requires that the selling broker furnish every condominium buyer with a copy of the Condominium Governance Form that is published by the Department of Business and Regulation (DBPR) Division of Florida Condominiums, Timeshares, and Mobile Homes. This five-page form is an informational and educational overview of condominium governance and ownership.

To read and download this form, please put this URL in your web browser:
http://www.myfloridalicense.com/dbpr/lsc/LSCMHCondominiumForm
Each condominium unit owner has a vote in the condominium association’s affairs. The condominium association membership (comprised of all unit owners) elects a board of directors to assume management responsibilities. The board of directors has the responsibility of developing the condominium association’s annual budget, which forms the basis for each condominium unit’s maintenance fee. If a condominium unit owner is in default in paying these maintenance fees, then the condominium association may record a lien against that condominium unit and its owners for non-payment with judicial enforcement that could lead to foreclosure court proceedings.

**Condominium Characteristics**

Condominiums have three fundamental characteristics.

- **Individual unit ownership.** The condo owner owns their individual apartment just as if it were a private home. Legally, it is considered real property. The owner receives a deed for the unit and the property can be held in severalty, as a joint tenancy, as tenants in common, or as tenants by the entirety.

- **Percentage ownership of common elements.** The condo owner owns an undivided percentage of the common elements of the building along with the other unit owners. These common elements include the land and the improvements, such as hallways, elevators, recreational facilities, and other areas common to the building. The individual owner’s share is usually determined by the square footage of their unit. The land and common areas are owned as tenants in common.

- **Governed by board of directors.** The condo is governed by a board of directors or board of managers that maintains the common elements and enforces the regulations. The condo owner is also subject to any state laws that govern condominiums. The condo rules are specified in the condominium documents and govern such things as the association dues, the hours the swimming pool is open, and whether or not pets are allowed.

**Condominium Documents**

A new condominium development is created by a developer (known as the sponsor) who obtains local planning commission approval and records the following documents. These documents establish a condominium association that has operational authority over the management of the common areas and enforcement of the bylaws and rules.

- **Declaration of Condominium.** The Declaration of Condominium explains the nature of the development project. It identifies the name of the condominium, the developer, and the principal officers. It describes the units, the way the condominium is governed, and how the dues will be assessed. It outlines repair and maintenance responsibilities and describes the ownership interest between the condo association and the owner. The declaration is recorded in the public records of the county in which it is located, at which point it becomes effective.
• **Articles of Incorporation.** The *Articles of Incorporation* describe the rights of the unit owners. It covers a number of issues from the rights and duties of the board to whether or not the unit owners can have pets. It generally includes key issues such as rental policy, vehicle parking rights, limited-common elements, leasehold obligations, and storage facilities. Even though this may be a long document, it is often easy for the layperson to understand.

• **Bylaws.** The *Bylaws* are the basic rules under which the condominium operates. Among other things, the bylaws do the following:

  o Specify the number of members on the board
  o Detail the nature of the officers and their duties
  o Identify the manner in which the board members are elected
  o Define the requirements of the annual membership meeting
  o Describe the voting rights of each owner
  o Set forth the number of board of director seats the sponsor can have, and when they must give up control
  o Describe any sublet provisions
  o Identify any restrictions on the use of the units and common areas
  o Describe the owners’ obligations to make repairs
  o Define the method for making changes to the bylaws

**Purchasing a Condominium**

A buyer of a condominium unit has the same opportunities for financing available to them as other real property owners. When a buyer purchases a condominium unit, they receive a deed for that ownership. The deed states that the buyer is the owner of a particular stated condominium unit number within the development plus an undivided fraction of ownership in the common areas with all of the other condominium unit owners.

In becoming an owner of that particular condominium unit, the buyer becomes the owner of a *cubicle of airspace* with common area ownership owning the structure itself. The condominium documents establish the demarcation lines of legal and financial responsibilities for repair and maintenance.

When choosing a condo, a buyer should look at all the same factors that they would if purchasing a private residence, such as location, size, available services, and price. Other factors the buyer should also consider include the purchase of a unit in a newly constructed or exiting building.

**The Offering Plan**

An offering plan, also known as a *prospectus* or *black book*, is intended to help buyers make an informed decision about their condominium purchase. The offering plan contains specifics about the project, including the number of available units, the size of the units and floor plans, common areas, recreational areas, landscaping issues, parking spaces, appliances, and amenities. Buyers should read the offering plan carefully to determine the sponsor’s obligations. If something is not specified in the offering plan, the sponsor is not obligated to provide it.

Things for the buyer to consider before purchasing a newly constructed condominium unit are outlined below.
Condominiums, Cooperatives, and Timeshares

- **Special risks.** Special risks indicate that what is listed in the offering plan is not what is actually delivered by the sponsor. Buyers should not rely on advertising brochures, verbal statements, or architectural renderings. For instance, in most developments, sponsors install minimal but adequate landscaping and when buyers want an upgrade of this item they must pay for it themselves.

- **Real estate tax validation.** The exact amount of property taxes on a condo may not be known until the project is actually completed. The financial section of the offering plan lists the projected real estate taxes for the condo. This projection is based on the current tax rate, the assessed value the municipality places on the property, and any tax abatements the developer may be entitled to receive. Many new developments receive tax abatements that result in very small, or even non-existent, taxes for the first several years after the building is completed. In any case, the exact taxes will not be known until the project is completed.

- **Floor plans.** The offering plan should have detailed information about the floor plans of all of the recreational facilities and buildings, as well as each of the individual living units.

- **Price increases.** There are circumstances when the price of a condominium may increase during the development cycle. For instance, the price of the raw land may have increased since the offering plan was filed or increases in construction costs over the life of a project may cause the price of the unit to increase. If the developer sells the first block of units very quickly, they may decide to raise the prices on the next block. In addition, the maintenance charges for the common areas may become more costly over time.

- **Hidden costs.** A buyer may think they are getting one thing and end up with something else instead. For instance, the sponsor may substitute a different brand of appliance from what was listed in the offering plan. Offering plans frequently state that the sponsor can substitute equal or better appliances, but not appliances of lesser quality. In addition, a buyer may want an upgrade of an item, such as better landscaping. When a buyer wants an upgrade of this type, they must pay for it themselves. Again, a careful reading of the offering plan will help the buyer determine if what he or she is receiving is part of the offering or is considered an upgrade that will incur extra charges.

**The Letter of Intent**

*A letter of intent* is a written statement that expresses the intention of the undersigned to enter into a formal agreement to purchase a condominium. The letter is a written offer to reserve a specific unit, although the agreement can be non-binding with regard to the exact buyer or the unit’s final price. Usually the letter of intent is used to create the purchase agreement. If an existing rental building is undergoing a conversion to a condominium, the letter of intent is used by any tenant who wants to purchase a unit when the conversion is complete.

A letter of intent contains the following information.

- **Price and deposits.** The price and deposits section states the purchase price. It also states an amount of deposit called the reservation deposit, which accompanies the letter of intent and is normally non-refundable. It also indicates an amount of earnest money the prospective buyer will pay when the contract is executed. Both the reservation deposit and the earnest money deposit will be held in escrow and applied to the purchase price at closing.
• **Completion date and closing date.** The *completion date* is specified, subject to delays beyond the control of the seller. The *closing date* is generally set for 30-days after the completion date.

• **Use of the unit.** For residential units, *use of the unit* section typically states that the unit is to be used for single-family residential purposes only.

• **Nonexclusivity.** *Nonexclusivity* means that the buyer agrees that, in absence of an executed contract, the seller may continue to market the unit. If the seller finds another buyer, the seller must notify the first buyer who will have a specified period to deliver a contract to the seller or the letter of intent will be cancelled.

A letter of intent may also have a clause that indicates that the letter is neither a specific offer nor a legally binding obligation. If the letter is non-binding, there are no legal damages to either party if one party defaults on the letter. However, in most cases, the letter is intended to create a binding agreement between the buyer and seller. In such cases, both parties are under the obligation to the other with respect to the performance of the terms of the letter and the proposed sale and purchase of the unit until a contract is agreed upon and executed by both parties. When that occurs, the contract supersedes the letter. If the letter is binding, it should stipulate what happens if one of the parties defaults.

**COOPERATIVES**

Cooperative Characteristics

Cooperative ownership dates back considerably longer when compared to the more recent history of condominium ownership. Cooperative ownership has very unique characteristics. In some cases, a developer creates a private corporation in the cooperative development's name. This newly formed private corporation becomes the owner of the land and the improvements. In other cases, a housing cooperative forms when people join with each other on a democratic basis to own or control the housing and/or related community facilities in which they live. Usually they do this by forming a not-for-profit cooperative corporation.

The main difference between a co-op and a condo is the form of ownership. While a condo owner actually owns the unit, which is treated as real property, a co-op member does not directly own any real estate. The corporation owns or leases all real estate.

Each unit in a cooperative is allocated a number of shares of stock. When buying into the co-op, a person is buying those shares in the corporation. As part of the co-op membership, the shareholder has an exclusive right to live in a specific unit (established through an occupancy agreement or proprietary lease) for as long as they want, as long as they do not break any of the rules or regulations of the cooperative.

The developer records documents initially that specify the bylaws of the corporation. Each shareholder has a vote in the cooperative corporation's affairs. The shareholders elect a board of directors with management and enforcement responsibilities similar to those outlined above in the case of condominiums.

Each month the shareholders pay an amount that covers their share of the operating expenses of the cooperative corporation. This maintenance fee, or rent, is applied to the costs of operating the building, the building’s real estate taxes, and the debt service on the building’s underlying mortgage.

Co-op members are entitled to a tax deduction for their portion of the building’s real estate tax, their portion of the building’s interest payment on its mortgage, and the interest payment on their own unit loan.
Unlike most condominium purchases, most cooperative corporation documents prohibit the outside financing of a share of stock in order to prevent an outside lender from becoming an actual shareholder through foreclosure on a borrower's default.

If you become involved in a cooperative sale, you should check on these types of unique matters beforehand to educate the participants in any cooperative transaction.

**Purchasing a Cooperative Unit**

Since shareholders own a piece of the cooperative corporation, it is important for them to know the financial health of the cooperative before they make the decision to purchase. Potential buyers should review the annual financial statement, with the help of their attorney or an accountant, before signing any contract. This review is known as *due diligence*. It is a good idea to review two years’ worth of statements. Often, a lender will ask a buyer to submit the financial statements of the cooperative or condominium before it approves a loan.

**Understanding the Financial Statements**

When looking over the financial statements, the potential buyer should focus on four critical parts:

- **Accountant’s opinion letter.** The accountant’s opinion letter should be located at the front of the financial statement and addressed to the board of the condominium association or Cooperative Corporation. The letter should have the phrase “presents fairly” and should not have restrictive language such as “subject to” or “except for.” If the letter has the words “compilation” or “review,” that means the financial statement has not been audited to verify that the information it contains is correct. A compilation or review opinion means that there is a problem and the prospective buyer should do further investigation to determine if issues exist. Reading the board’s minutes could be very helpful in this investigation.

- **Statement of financial position.** The statement of financial position is also known as the balance sheet. The balance sheet is a financial snapshot of the condo or co-op that shows its assets, its liabilities, and its net worth, stockholder capital, or equity (equal to the assets minus the liabilities). This snapshot is taken at a specific point in time, usually December 31st, but the statement may not be ready for several months afterward. The important components of the statement include information about the financial resources (cash, cash equivalents, and reserve funds), accounts receivable, accounts payable, and mortgage balances.

- **Income statement.** Also called the statement of operations, the income statement shows the stream of activity during a certain period, usually one year. It tells what has been earned, what has been spent, and what is left over. Most cooperatives show a negative net income. This is not a problem. If the income collected is about the same as what has been disbursed, then the depreciation creates a negative income figure. If the depreciation is added back to the net income, the result is the amount of positive cash flow that was received by the building. This is the amount of money added to the building reserve fund. It’s important to remember that a cooperative’s aim is not to make a profit, which would be subject to tax. The co-op’s goal is to cover costs and build adequate reserves.
- **Notes to the financial statement.** The notes to the financial statement at the end of the statement clarify the information that was presented. Some of the notes deserve special attention.

  - Note about the mortgages giving maturity date, amount of the monthly payment, and any special terms
  - Note relating to the terms of the lease if the building is on a land lease
  - Note relating to the reserve funds. The funds should be in appropriate financial instruments and there should be no indication of lending arrangements that show the co-op or condo is borrowing from the reserve funds.
  - Any note that is related to contingent liabilities or legal matters which might describe matters such as a pending lawsuit

**Board Meeting Minutes**

When considering a co-op purchase, it is helpful to the prospective buyer to review the board meeting minutes. The minutes can provide information regarding some critical areas.

- **Maintenance and assessment history.** The income statement shows how much of the budget is being spent for maintenance and repairs. Maintenance and repair is the cost of keeping the building clean and operating in a manner that is consistent with the homeowners’ expectations. If the expenditures are high, it might mean that the building is vigorously maintained, or it could mean that the building’s systems are becoming obsolete and cost more to be kept operational. This might imply that a future assessment or maintenance increase will be necessary to replace a system that has become too expensive to maintain. Conversely, if the maintenance costs are low it could mean that the building has new systems that are under warranty and not in need of a great deal of maintenance, or it could be that the building is not being managed correctly or properly maintained.

  During its scheduled meetings, the board may discuss maintenance issues and make decisions about whether they will need special assessments during the year to cover certain expenses. Reading the minutes will give the prospective buyer an idea of what maintenance issues are of concern to the cooperative board.

- **Underlying mortgage.** Most co-op buildings have one or more mortgages on the entire building. This is what is known as the underlying mortgage. The financing of the co-op’s underlying mortgage is one of the most significant factors in the fiscal integrity of the building. The size of the mortgage and the corresponding monthly payments have a significant impact on the value of each individual unit.

  Before making a purchase, prospective buyers should determine what type of mortgage exists, how many mortgages there are, and when the mortgages will mature. The financial statement will have this information. If the mortgage is maturing soon, it may have to be refinanced which could be a large expense to the co-op corporation. However, this is not always a negative thing. It is true that once the loan is refinanced, the principal portion of the payment is low and the interest payment is high, but that means the maintenance goes down while the tax deduction goes up.

  Again, reading the board minutes can give the prospective buyer information about the status of the mortgages that can’t be found in the financial statements.
• **Reserve fund.** Information about the *reserve fund* can usually be found in the financial statement, but it may also be addressed in the board minutes. The reserve fund is the money that is set aside for major capital improvements, unexpected repairs, or replacement of building systems. If the fund is large enough, there may be no need for increased maintenance fees, assessments, or new loans. If there is a shortfall, shareholders might have to absorb maintenance increases to cover the cost of the installation of new building systems, or to pay the interest and principal on a loan. Some co-op boards pass the expense to shareholders through assessments rather than maintenance fee increases.

**Cooperative Documents**

Since the purchase of a co-op is different from the purchase of the real property of a condominium, the documents needed for the transfer of the property are also different. As we discussed earlier, co-op residents do not actually buy their individual unit; they purchase the shares in the cooperative corporation that are allocated to a particular unit. The contract to purchase the shares is called a *subscription agreement*. The subscription agreements are prepared by the cooperative sponsor and are included in the offering plan. In addition to the subscription agreement, the documents typically needed for a cooperative transfer include:

- Proprietary lease
- Articles of incorporation
- Bylaws
- House rules

**Purchase Documents**

When the buyer closes on a purchased unit, they receive *stock certificates* in their name. The certificates could be issued one-per-share or there could be just one certificate that states the total shares the buyer has.

As we mentioned earlier, co-op buyers do not receive a deed to their property. Instead, ownership of the shares entitles the buyer to a long-term *proprietary lease* for the unit. The lease defines the buyer’s rights and obligations with respect to the possession, use, and occupancy of the unit. The lease is delivered to the buyer at closing.

**TIMESHARES**

**Timeshare Characteristics**

Timeshare ownership is set up initially by a developer of a timeshare development, which will have condominium governance as outlined above. However, with timeshare ownership, no one owner owns an entire unit alone. Instead, each timeshare owner owns a fractional share of ownership based upon a certain period of use (for example, one week).
Types of Ownership

There are two types of timeshare ownership: interval and right to use.

- **Interval ownership.** With *interval ownership*, the buyer purchases real property (although only for an interval of time during any one year) and receives a deed just like in other types of real property ownership. Interval ownership allows the owner all of the ownership rights available. This is thought to be the best way to purchase and own a timeshare. An interval owner has the right to resell, gift, or will that ownership.

- **Right to use.** With the *right to use* type of ownership, the buyer does not purchase ownership rights but just the right to use and possess a unit for a specified period during any one year for a stated number of years. When that stated number of years is over, the buyer has used up all of their use and possession rights and has nothing left. Hence, many refer to this as a *vacation lease*.

Timeshare Disclosure Requirements

If you are involved with any timeshare transactions, you should become familiar with all of the strict disclosure requirements as stated in the Florida law for Vacation and Timeshare Plans as outlined in F.S. 721.

Some of the required disclosures when selling new timeshare units are:

- Buyer has a 10-day rescission period to cancel a sales contract with no penalty.
- Timeshares should be purchased for the purpose of leisure-time activity instead of for investment appreciation.

Some of the required disclosures when selling resale timeshare units are:

- No guarantee that timeshare can be sold for a particular price or within a particular period.
- Amounts of assessment fees and the fact that assessment fees may increase.
- Amount for property taxes, if not included in assessments for common expenses, and consequences that result from non-payment of property taxes.

**HOMEOWNERS’ ASSOCIATION (HOA)**

Ownership of real property within a *homeowners’ association (HOA)* occurs because a developer of, or owners in, a subdivision record private subdivision restrictions that affect all owners and all subsequent buyers in that particular subdivision. Because these subdivision restrictions are private, their enforcement is the legal and financial responsibility of those who benefit from them. Consequently, subdivision restriction documents create a homeowners’ association, which assumes these managerial and enforcement obligations with mandatory membership of all owners and all subsequent buyers.
If you are involved in transactions with private restrictions, you should obtain copies of these documents from the beginning of your transaction and have them available for potential buyers to review.

**Required HOA Disclosures**

Homeowners’ associations are governed by F.S. 720. If a sales contract does not conform to the requirements of this subsection in Florida law, the buyer may void it within three days, or prior to closing, whichever comes first.

Florida law requires that a homeowners’ association disclosure be provided to buyers when membership in such an association is required. Initial developers and subsequent owners must disclose to a buyer who signs a sales contract that:

- The owner is required to be a member of the HOA.
- Recorded private restrictions govern the use and occupancy of the property.
- The owner is obligated to pay assessments to the HOA with failure to pay leading to possible lien recording and enforcement with foreclosure.
- There may be land use and/or recreation fees. If so, the amounts of such obligations must be disclosed in the contract.

**COMMUNITY ASSOCIATION MANAGEMENT LICENSE**

Certain property managers who are employed and compensated by community associations are required by Florida law to obtain and maintain a Community Association Management (CAM) license. [F.S. 468]

A CAM license is required when the community association employs a property manager who receives compensation for those services, and the community association served contains more than ten units or has an annual budget in excess of $100,000.

Property management activities compensated for include:

- Controlling or disbursing association funds
- Determining how or when to prepare budgets or other financial documents for a community association
- Determining how or when to provide notice of meetings or to conduct community association meetings
- Maintaining and/or having authorization to spend community association petty cash
- Coordinating maintenance for the residential development
Community association compensated property management can be applicable to mobile home parks, planned unit developments, homeowners’ associations, cooperatives, timeshares, condominiums, or other residential units which are part of a residential development scheme and which are authorized to impose a fee that may become a lien on the parcel in the case of non-payment.

Who Does Not Need a CAM License?

There is no Florida license for a property manager. Therefore, a CAM license is not applicable to the management of apartment buildings, commercial properties, or investor-owned single-family dwellings.

In addition, community associations are not required to hire outside property managers. The community association board members and officers can perform the property management services without obtaining a CAM license provided they receive no remuneration or compensation.

A person does not require a CAM license if they perform clerical or maintenance functions under the direct supervision and control of a licensed manager, and do not assist in providing any management services.

CAM Licensing Requirements

In order to obtain a CAM license, an applicant must meet all of the following criteria:

- Be at least 18 years of age and be of good moral character as defined by Florida Administrative Code

- File a complete and accurate application with the State of Florida

- Submit electronic fingerprints and pass a criminal background check

- Pay appropriate fees

- Satisfactorily complete a minimum of 18 hours of pre-licensure education (classroom or distance learning) within 12 months prior to the date of taking the CAM exam

- Pass a State of Florida CAM license exam of 100 multiple-choice equal weight (1-point each) questions with a passing score of 75 or better through the computer-testing vendor Pearson VUE

All CAM licenses expire on September 30th of every even-numbered year. All CAM licensees must satisfactorily complete a minimum of 20 hours of approved continuing education instruction during each license renewal period.
CHAPTER 11 REVIEW QUESTIONS

1. Community associations are governed by the following Florida Statutes: (1) Condominiums: F.S. ______; (2) Cooperative: F.S. ______; (3) Timeshares: F.S. ______; (4) HOAs: F.S. ______.

2. A ______________ is a building in which each owner becomes the owner of a particular unit within the development plus an undivided percentage ownership of the ______________ of the building.

3. In a condominium development project, the ______________ describe the rights of the unit owners and the ______________ specify the basic rules under which the condominium operates.

4. The ______________, also known as a prospectus or black book, is intended to help condominium buyers make an informed decision about their condominium purchase.

5. A ______________ is a written statement that expresses the intention to enter into a formal agreement to purchase a condominium. It is usually used to create the ______________.

6. The main difference between a co-op and a condo is the ______________. A ______________ unit owner actually owns the property. Whereas, a ______________ unit owner owns ______________ in the corporation; the corporation owns all real estate.

7. Each month the shareholders in a cooperative pay an amount that covers their share of the ______________ of the cooperative corporation. This fee is applied to the building operating costs, real estate taxes, and the debt service on the building’s mortgage.

8. Cooperative members are entitled to a tax deduction for their portion of the building’s: (1) ______________, (2) ______________ on the mortgage, and (3) ______________ on their own unit loan, although most cooperatives prohibit outside financing of shares of stock to prevent an outside lender from becoming a shareholder through ______________.

9. A cooperative’s ______________ (also known as the balance sheet) is a financial snapshot of the co-op’s assets, liabilities, net worth, stockholder capital, or equity.

10. A potential co-op buyer should review the ______________, which contains information on the maintenance and assessment history, underlying mortgage, and reserve fund.

11. The contract to purchase shares of a co-op corporation is called a ______________.

12. There are two types of timeshare ownership: ______________ and ______________.

13. The following disclosures are required when selling new timeshare units: (1) the buyer has a ______________ rescission period to cancel a sales contract with no penalty, and (2) timeshares should be purchased for ______________ instead of for ______________ appreciation.

14. A CAM license is required when a community association employs a property manager who receives ______________, and the community association served contains more than __________ units or has an annual budget in excess of ______________.

15. Compensated property management activities include: (1) disbursing association ______________, (2) determining how or when to prepare ______________ or other ______________ documents, (3) determining how or when to provide ______________, and (4) coordinating ______________.
CHAPTER 11 PRACTICE EXAM

1. Which type of purchase most closely resembles the purchase of a single-family residential purchase?
   a. Timeshare unit with interval ownership
   b. Timeshare unit with right to use ownership
   c. Condominium unit
   d. Cooperative unit

2. What can happen if a condominium owner is in default from failure to pay their share of the condo maintenance fees?
   a. A lien could be recorded with judicial enforcement that could lead to foreclosure.
   b. The condo association could request that the lender initiate foreclosure proceedings.
   c. The condo association could prevent owner access to the unit until the fees are paid.
   d. The amount of unpaid fees would be deducted from the owner’s mortgage payments.

3. The Declaration of Condominium is recorded in the public records and explains the nature of the condominium development project. What is NOT included in these documents?
   a. Name of the condominium, developer, and principal officers
   b. Description of the way the condominium is governed
   c. How dues will be assessed
   d. Name and contact information for all unit owners

4. In what document would a condominium buyer find specifics about the number of available units, the size of the units, floor plans, and common areas?
   a. Plat diagram
   b. The offering plan
   c. Condo bulletin
   d. Shared newsletter

5. Which statement is INCORRECT regarding subdivision restriction documents that are recorded for a private subdivision?
   a. Mandatory membership is required for all owners and subsequent buyers.
   b. Managerial responsibility must be delegated to an impartial CAM who is not an owner.
   c. Enforcement is the legal and financial responsibility of the owners who benefit from the restrictions.
   d. They create a homeowners’ association.

6. Which individual must obtain and maintain a Community Association Manager (CAM) license?
   a. A volunteer owner who performs property management services for a 6-unit residential community
   b. A paid property manager for a 30-unit apartment building
   c. A paid employee of a licensed CAM who provides clerical support
   d. A paid board member who performs property management services for a community with an annual budget of $150,000

7. Under Florida condominium law, how many days does the very first buyer from a developer have to rescind a purchase offer?
   a. 15 business days
   b. 3 business days
   c. 15 calendar days
   d. 3 calendar days

8. What is obtained by the buyer in a co-op real estate transaction?
   a. A number of cooperative points
   b. Ownership of the co-op unit for a specified time interval
   c. Ownership of the co-op unit
   d. A number of shares of stock
9. Which document shows how much of a co-op's budget is being spent for maintenance and repairs?
   a. Income statement
   b. Accountant's opinion letter
   c. Statement of financial position
   d. Notes to the financial statement

10. What due diligence is especially important when making the decision to purchase a co-op unit?
   a. Obtain a copy of the deed.
   b. Understand the financial health of the cooperative.
   c. Obtain the lowest price.
   d. Meet the neighbors in the nearby units.

11. Buyer Frank just closed on a property with the right to use and possess the unit for a specified period during any one year for ten years. What type of property did Frank buy?
   a. Cooperative unit
   b. Condominium unit
   c. Timeshare unit with a vacation lease type of ownership
   d. Timeshare unit with interval ownership

12. A letter of intent is a written statement of the intention to purchase a condominium. Which information is NOT included?
   a. Exclusivity - the seller may not continue to market the unit
   b. Price and deposits - the stated purchase price and reservation deposit
   c. Closing date - subject to delays beyond the seller's control
   d. Use of the unit - stating use for single-family residential purposes only

13. According to Florida condominium law, every condominium buyer has the right to obtain certain documents from the seller. Which document is NOT included?
   a. Stock Portfolio Prospectus
   b. Declaration of Condominium
   c. Articles of Incorporation
   d. Bylaws and Rules of the Association

14. Florida law requires that specific HOA disclosures be provided to buyers when membership is required. Which statement is NOT one of these disclosures?
   a. HOA membership is required for all owners.
   b. Recorded private restrictions govern the use and occupancy of the property.
   c. All subsequent sale of the property must be approved by the HOA board of directors.
   d. The owner must pay HOA assessments, which are enforced with possible lien recording.

15. Which characteristic does NOT apply to condominium ownership?
   a. Individual unit ownership
   b. Ownership by a corporation governed by bylaws
   c. Percentage ownership of common elements
   d. Governed by a board of directors according to specified rules
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REAL ESTATE INVESTING AND TAXATION

OVERVIEW

While saving means accumulating money, investing means using money to earn more money. A basic goal of investing is to generate more income and create wealth. Unlike stock market investments, when investing in real estate the control remains in the hands of the investor. The investor makes their own decisions that affect the future of the investment. In addition, the investor can structure purchase and sales according to their particular needs.

An investor can realize profits from real estate in several ways, such as positive cash flow, tax benefits, and appreciation that are realized at the time of sale or are realized by borrowing on the equity. Property can also serve as a hedge against inflation. In addition, property investments are considered long-term and low-risk, as compared to some other types of investments.

However, as with any investment, an investor can also lose money. With property investments, this usually happens as negative cash flow or loss realized when the property is sold.

Real estate investing is a complex process. In this chapter, we will discuss some of the characteristics of investing, the different types of investment properties, the steps to investing in real estate, and the types of analysis an investor should perform when considering an investment.

OBJECTIVES

After completing this chapter, you should be able to do all of the following:

- Describe the characteristics of real property investment
- Identify and discuss the types of real estate investment properties
- Discuss the steps in real estate investment
- Explain financial analysis, including deriving net operating income, before and after tax cash flow
- Explain real estate taxation, including capital gains and losses, and depreciation
- Discuss tax shelters and property exchanges

REAL ESTATE INVESTMENT

As a real estate professional, you would be wise to be open to all real estate service opportunities. One area that offers abundant opportunities is working with investors who want to buy, sell, rent, lease, and/or exchange all different kinds of investment properties.

Investments of all types are continuously competing with one another for the finite number of investment dollars available in the marketplace at any given moment. The benchmark for evaluating the pros and cons of investments is normally U.S. government securities, which have extremely low, if any, risk of loss to an investor but have produced historically low yields. Other investments with increased risk often have proportionately increased yields.
Characteristics of Real Property Investment

The goal of investing is to realize profits. Investors do this by weighing several factors. These factors include risk, liquidity, and leverage.

- **Risk.** Risk is the chance of experiencing a loss. The loss can be either monetary or non-monetary. A loss can be real even if it is only considered a loss by one individual. Often, the greater the risk of loss, the greater the potential rate of return on the investment. Investors want both a return of their investment (the recovery of the invested monies) and a return on the funds in the form of a profit.

  When determining where to invest their funds, investors calculate a rate of return on the investment to see which investment will perform the best. Property investments must offer the promise of higher returns in order for an investor to choose property over other, safer investments. For instance, if an investor knows that they can get a 5% return on a treasury bond, they will expect more from a property investment because of the risks involved. Sometimes after an investor examines all the factors involved, they determine that the risk in not worth the return that they would realize.

- **Liquidity.** Liquidity refers to an asset’s ability to be easily converted through an act of buying or selling without causing a significant movement in the price and with minimum loss of value. Cash is the most liquid asset. A liquid asset can be sold rapidly with minimal loss of value. The essential characteristic of a liquid market is that there are ready and willing buyers and sellers at all times. An illiquid asset is one which is not readily saleable due to uncertainty about its value or a lull in the market in which it is regularly traded. Property is considered an illiquid asset, which cannot be transferred as easily as other assets, such as stocks or bonds.

- **Leverage.** Leverage is the use of borrowed funds to increase the potential return of an investment. Financial leverage is created by mixing borrowed funds with equity (the cash contributed by the investor). The higher the ratio of borrowed funds to equity, the greater the degree of leverage. Leverage magnifies both gains and losses. When the rate of return exceeds the costs of borrowing, the leverage is said to be favorable or positive. If the cost of borrowing is greater than the return, then the leverage is unfavorable or negative.

  Financial leverage can be measured as a debt-to-equity ratio, that is, total liabilities divided by shareholders’ equity. In the real estate market, the ratio between borrowed funds and the market value of the property being financed is more commonly used and is the loan-to-value ratio (LTV).

Advantages and Disadvantages of Real Estate Investment

An investment in real estate is normally referred to as the purchase of real property for a certain value that will yield a desired capitalization rate (profit return on investment) based upon the premise of receiving anticipated income and/or anticipated appreciation in value over a predetermined period. There are both advantages and disadvantages associated with investing in real property.
Advantages of investments in the real estate industry include:

- Relatively high yields
- Leveraging opportunities
- IRS federal income tax deductions, allowances, and credits
- High degree of personal control

Disadvantages of investments in the real estate industry include:

- Relatively illiquid
- Large capital requirements
- Necessity of constant management
- High risk of loss

**TYPES OF REAL ESTATE INVESTMENT**

Investment properties fall into a number of categories:

- Unimproved land
- Office buildings
- Residential properties
- Mixed-use buildings
- Commercial/retail properties
- Industrial properties

**Unimproved Land**

Investment in unimproved or undeveloped property is probably the riskiest of all property investments, as it can be the most illiquid of all property types. *Unimproved property* is a long-term investment with a negative cash flow. Even if the investor pays for the property in full, they must still pay the yearly taxes, which could increase significantly over time. In addition, since there are no improvements on the property, there are no depreciation benefits with unimproved ground.

Another disadvantage in purchasing unimproved property is that the zoning of the land can change. A change in zoning could mean a change in the property’s value. A change from residential to commercial could result in a substantial increase in value. Conversely, a change from commercial to residential could have serious adverse effects on the property’s value. In addition, governments can impose building restrictions that could limit or even prohibit development until utilities are brought to the site. These utilities could be charged to the property owner.

On the other hand, the advantage to investing in unimproved property is that it offers excellent appreciation potential with the added benefit of no management issues. If there are no tenants and no buildings, not much can go wrong. The greatest increase in the value of real estate comes from taking vacant land with the lowest basic value and turning it into a high-value property, ranging from commercial sites to parks. When circumstances are favorable and the investor knows what the future plans are for the area, land investment is not a risk for investors that have the time and the ability to hold the property.
Office Buildings

An office building can be a major multi-tenant building in the central business district of a large city or it can be a single tenant building, sometimes built for a specific tenant’s needs, such as a medical office building near a hospital. It can range in size from a few hundred square feet of small offices to a complex with several million square feet.

Office buildings are found in any number of areas: business districts, suburban areas, small residential neighborhoods, and large specially built office parks. Modern high-rise buildings have tended to replace older, smaller buildings in central business districts, while one-to-two-story office centers typically spring up in office parks in the suburban areas.

Office buildings vary by size.

- **Low-rise.** Low-rise buildings have few stories, usually one to three, and may have no elevator.

- **Mid-rise.** Mid-rise buildings are moderately tall, averaging four to fifteen stories, and typically have one elevator.

- **High-rise.** High-rise buildings are normally over 15 stories tall and have multiple elevators. High-rise buildings are not as tall as skyscrapers. High-rise buildings tend to have multi-tenant floors near the base of the building and single-tenant floors near the top. This helps use the building space in the most efficient manner possible.

- **Garden office.** Garden office buildings are one to five story buildings with extensive landscaping.

- **Research and development.** Research and development (R&D) buildings are typically one or two stories with up to 50% office or dry laboratory space and the rest workshops, storage, and possibly light manufacturing.

- **Flex space.** Flex space buildings are usually one or two stories that can accommodate warehouse and light industrial activities in addition to offices.
Residential Property

Reasons for Investment

There are two main reasons that investors purchase residential property:

- **To keep.** Some investors purchase property *to keep*, which means that they will buy the property and hold it for the long term in an effort to get income, see the property appreciate in value, and sometimes gain tax benefits.

- **To flip.** The other reason investors purchase property is *to flip it*. This is when an investor buys a property with the intention to sell it as soon as possible. Investors that intend to flip properties feel that they can make a profit either with or without renovation, repairs, or improvements.

Types of Residential Investments

While the purchase price for a home is always important, it is not as critical for homes that will be held as it is for homes that will be flipped. There are a number of investment alternatives available to an investor, depending on the amount of time they have to spend on the investment process, as well as the investor’s individual talents and goals.

The residential properties that can make good investments are:

- **Single-family homes.** *Single-family homes* are described as detached units found in subdivisions, neighborhoods, or in cluster home developments, where the owners share outdoor and common areas. Most of the time there are a large number of single-family homes available on the market. Managing a single-family home is easier than almost any other type of residential property. The single-family home normally has an active resale market, which can offer a high amount of liquidity for investors. In fact, single-family homes are the most liquid of all real estate investments and are the most easily rentable.

- **Vacation homes.** *Vacation homes* can make good investments. Many investors purchase a vacation home for enjoyment, as well as investment. The fact that interest and property taxes are tax deductible helps to offset the cost of the second home. If the investor lives in the vacation home for 14 days a year or less, they can take depreciation on it. However, if the investor lives in the home for longer than 14 days, no depreciation is allowed. Therefore, many investors use a vacation home a few weekends a year and then rent it out at all other times in order to be able to take depreciation.

  Vacation homes that tend to be the most desirable include homes in warmer locations like Florida, California, and Arizona, homes at ski resorts, and homes near bodies of water. If there is a popular recreation nearby, almost any residence provides a good second-home investment.
Condominiums and cooperatives. The advantage of investing in a condominium is that it is relatively easy to rent, while providing less direct owner involvement. In a condominium complex, the grounds and exterior maintenance are handled by an association, so the investor doesn’t have to provide those services. On the other hand, a disadvantage is that a condominium appreciates at a much slower rate than other units do.

Before an investor considers purchasing a condominium, it is important that they check the restrictive covenants carefully. Sometimes condominiums and cooperatives have rental restrictions that might clash with the investor’s plans. It’s also important to find out if the condominium has any special assessments for unusual expenses. Because the condominium is governed by an association, the owner has less control over the costs.

Fixer-uppers. Purchasing a fixer-upper for resale could be a complicated, but profitable, proposition. If the home is unattractive or undesirable because of a defect that can be cured, it could be a good investment.

Property that is in poor condition could be on the market for a long period. When that happens, opportunities become available in both price and terms for this kind of property. Generally the worse a property looks, the better the deal an investor can make. Property in poor shape can often be purchased at a good price with very attractive owner financing. Some of these properties may be in foreclosure, being sold as part of an estate, or have already been foreclosed on and are being held by a lender.

If an investor buys an older property in need of repair and then makes it as attractive as other properties in the neighborhood, the investor will significantly increase the value of that property. One of the advantages is that the initial cost of the property plus the cost of renovation could be far less than the value of the comparable properties, making the profit potential for the renovated property substantial.

In addition to repairs and improvements, investors must also consider renovation, which is the replacement of outdated amenities, particularly kitchens and baths. Money spent in renovating kitchens and bathrooms usually results in at least a two-to-one ratio of increased value.

Multifamily dwellings. Another category of residential housing is referred to as multifamily housing. Multifamily housing is usually distinguished by its location, whether urban or suburban, and its size, whether high-rise, low-rise, or garden apartments.

Two- to four-family dwellings, such as duplexes, triplexes, and fourplexes are sought after investment vehicles, even though in certain areas they may be hard to find. These units are relatively easy for investors who are new or inexperienced, are very popular among investors, and usually have good resale value.

There are several laws that protect those who invest in one-to-four family buildings that don’t apply to larger buildings. These laws include prepayment privileges, provision for late charges, and other consumer protection laws.

One of the reasons that these types of properties are so popular is that an investor can choose to live in one of the units, while renting out the remaining units. This helps the investor with the purchase of the property. While the initial
rents may not be enough to make the mortgage payment, the additional cash
needed for the payment will often be less than what the investor would pay for a
comparable single-family home. Although the investor cannot take depreciation
on the apartment that they live in, the investor can depreciate the other units in
the building. This will help in securing a net positive cash flow.

- **Apartment building or complex.** If the
  supply of apartment homes is greater than
  the demand, it will be easy for an investor
to obtain an apartment building or complex
at an extremely fair price, often at less
than the current construction costs.
However, when this happens, an owner
must be able to withstand the temporary
financial losses they might incur due to
excessive vacancies.

At times when money is tight and construction costs are increasing, the
construction of new apartment buildings falls off dramatically and sometimes may
even come to a standstill. When new construction stops, the demand for
apartments increases and the vacancy rate declines. This stabilizes the rental
market, and investors can raise their rents, allowing investors to move from the
position of a negative cash flow to either break-even or even a positive cash flow.

When yields from apartment buildings rise, most investors are not interested
in selling unless they can get a premium price for the property. That tightens the
market, thereby causing interested investors to bid against one another for
desirable apartment buildings in key locations. If the bidding becomes intense,
investors could end up paying a higher price for a property than the net operating
income can support. This might lead to rent increases on the property.

Then a cycle begins, with periods of high vacancy and lower rents, followed
by periods of low vacancy with higher rents. In order to deal with the ebb and
flow of these potential cycles, an investor must have enough capital to keep the
property going during the high vacancy, low rent times, at least until the investor
can increase the rents to reflect the fair market value of the property.

**Mixed-Use Property**

*Mixed-use* development is the practice of
allowing more than one type of use in a building
or set of buildings. In planning zone terms, this
can mean some combination of residential,
commercial, industrial, office, institutional, or
other land uses. Mixed-use buildings combine
several unrelated or loosely related building
uses into one building.

For instance, consider a building that
contains retail and restaurant space at the ground floor, office space above, and
residential units above that. By not being devoted to a single use, these buildings bring
more varied and interesting life. They also create the opportunity for people to live close
to their place of work.

Over time, zoning laws have been revised to allow for mixed-use buildings. A mixed-use
district will most commonly be the downtown of a local community, ideally
associated with public transportation. Mixed-use guidelines often result in residential
buildings with street-front commercial space.
Retailers have the assurance that they will always have customers living right above and around them, while residents have the benefit of being able to walk a short distance to get groceries and household items or see a movie. From an investor standpoint, a mixed-use environment generates benefits that translate into higher rents and better leasing.

**Commercial/Retail Properties**

*Commercial/Retail properties* (or centers) differ in size and fall into categories with distinct functions. Each center usually has a main tenant called an *anchor tenant*. It is often essential to have a lease commitment from an anchor tenant before a lender will agree to the financing for the shopping center.

- **Shopping malls.** By definition, a *shopping mall* is a public area with a complex of shops with associated walkways and parking areas. Many shopping malls are enclosed or covered to allow for the same climatic conditions year-round.

- **Mega malls.** *Mega malls*, also called *super regional centers*, offer extensive variety in general merchandise, clothing, furniture, and home furnishings as well as a variety of other services and recreational facilities. They are usually anchored by three or more full-line department stores of at least 75,000 square feet each. One of these centers usually has about one million square feet of leasable space.

- **Neighborhood centers.** *Neighborhood centers* provide for the day-to-day living needs of the immediate neighborhood. They are usually anchored by a supermarket and have a total leasable space of 60,000 to 100,000 square feet. Tenants in the neighborhood center are similar to the strip center and might include a drugstore, laundry facility, barbershop, shoe repair shop, shipping store, and small restaurants.

- **Outlet centers.** An *outlet center* is a type of *specialty center* in that it does not fit into any other category. It has its own focus, which is typically to sell the merchandise of particular manufacturers at a discount. An outlet center is usually anchored by at least two large discount stores and has a total leasable space of 100,000 to 300,000 square feet.

- **Regional centers.** *Regional centers* provide general merchandise, clothing, furniture, and home furnishings as well as other services and recreational facilities. They are anchored by one or two full-line department stores of at least 50,000 square feet each and have a total leasable space of about 500,000 square feet. These centers provide services that are typical of a business district.
• **Strip centers.** Strip centers, also called convenience centers, provide for the sale of personal services and convenience goods. These are usually anchored by a convenience store (minimarket) and have a total leasable area of up to 30,000 square feet. Tenants in a strip center might include a dentist office, beauty salon, dry cleaner, or small restaurant.

**Industrial Properties**

Industrial properties may be located in industrial areas or planned business parks or they may be stand-alone buildings. Industrial property is typically divided into three primary categories:

• **Warehouse/distribution.** Warehouse/distribution buildings focus on storage and distribution of goods. They vary in size according to the type of goods being stored, but, generally, they are large, flat sites with space for maneuvering trucks and access to transportation facilities. They typically have a small amount of office space to accommodate the purchasing, accounting, and marketing personnel. The buildings usually have an attractive front with lots of windows for the office staff and good truck access to the back or side of the building where the docks and drive-in doors are located.

• **Manufacturing.** Manufacturing buildings are large facilities designed to accommodate the equipment for various manufacturing processes. Light manufacturing buildings can be up to 300,000 square feet, while heavy manufacturing can utilize up to one million square feet or more. These buildings usually need large bay doors with at-grade or dock-high parking for the truck to maneuver.

• **Flex.** There is no clear-cut definition of flex space, but it is typically defined as anything between offices and warehouses, usually combining the uses of both. Flex buildings are often one- or two-story buildings ranging from 20,000 to 100,000 square feet. The use pattern is typically 25% office space to 75% warehouse space, although the proportion in new buildings seems to be shifting in favor of more office space.

**REAL ESTATE INVESTMENT STEPS**

The typical steps involved in the purchase of a real estate investment are listed below. These steps are different from the steps involved in acquiring owner-occupied residential properties.
1. Establish the investor’s desires.
2. Set up capital structure and resources.
3. Select a team of consultants and advisors.
4. Conduct initial property investigations.
5. Present a letter of intent for the selected purchase.
6. Negotiate the offer and acceptance.
7. Prepare the formal sale and purchase contract for signatures.
8. Perform purchaser’s due diligence.
9. Close the sale and legally transfer the title.

The purchaser's due diligence (step 8) should include three separate and detailed feasibility studies and analyses. These are the market analysis, the property analysis, and the financial analysis.

The Market Analysis

Part of performing due diligence is the market analysis. The market analysis includes gathering data and analyzing environmental impact issues, governmental regulations, and a community profile.

- **Environmental concerns.** Environmental concerns include federal and state environmental protection agency requirements, permits, and approvals. The market analysis also looks at the issue of the presence of any hazardous substances on the property as it is addressed in strict federal and state laws. [Comprehensive Environmental Response, Compensation, and Liability Act passed in 1980 (CERCLA)]

- **Government regulations.** The market analysis also addresses government regulations that may affect the property, operations, or development. Such governmental regulatory concerns require research into subdivision regulations, plat approvals, and zoning. Zoning codes are of particular importance when setback requirements and planned unit developments directly relate to the usage of the property.

- **Community profile.** The market analysis includes a community profile that accumulates and analyzes a great deal of information about the surrounding neighborhood in which the subject property is located. This information provides knowledge of the surrounding economy, occupancy rates, transportation, utilities, facilities, and community acceptance.

The Property Analysis

The property analysis includes gathering data and analyzing the following:

- Specifics about the site, both surface and subsurface features and characteristics
- Exterior and interior issues
- Operating expenses
- The possible presence of items such as asbestos, lead-based paint, radon gas, and toxic mold.
The Financial Analysis

The financial analysis includes calculating and analyzing the following investment measurements:

- Net operating income (NOI)
- Before-tax cash flow (BTCF)
- After-tax cash flow (ATCF)

The financial analysis is usually thought of as being the backbone of any acquisition of an investment in the real estate industry.

Net Operating Income (NOI)

Net operating income (NOI) is the term that describes the net income produced by a specific property after all expenses have been deducted from the gross income. The net operating income is affected by market rent, vacancy, and operating expenses.

- **Market rent.** Market rent, also known as economic rent, is the price that a specific type of property is likely to draw under the current market conditions. The market rent could be higher or lower than the amount the property is actually renting for under its current lease. The rent depends on the national economic outlook, the economic base of the property’s surrounding area, the demand for the type of space the particular property provides in the local area, and the availability and supply of similar competitive space.

- **Vacancy.** At any particular point in time, some of the space available in a building might not be leased, thereby creating a vacancy. Some tenants leave after the lease has expired. Some tenants even walk away from their lease before it expires. In cases of newly constructed buildings, some of the space might not yet have been rented.

  In order to determine how much income a property might bring, an investor must try to predict how much of the space will be occupied by tenants during the period in which the investor expects to hold the property. The investor must always allow for periods of vacancy in the projections, even if the leasing activity is strong.

  When a current tenant leaves, the owner needs time to make the space ready for new tenants. Consequently, an investor must take into account and plan for some loss of rent during the holding period.

- **Operating expenses.** Operating expenses include fixed expenses, variable expenses, and a reserve for replacements.
  
  - **Fixed expenses (FE)** include costs that do not change with the level of occupancy, such as real estate taxes and hazard insurance.
  
  - **Variable expenses (VE)** change with the level of occupancy and include management fees, maintenance, utilities, yard care, and janitorial services.
Reserve for replacements (R) is money that is reserved for future use to replace worn-out components, called short-lived items, such as carpeting, appliances, central heat and air conditioning systems, and roof coverings.

Note: Mortgage payments, called debt service, are not considered an operating expense. The mortgage is an expense of the investor, not of the property’s operation.

Calculating the Net Operating Income

Once an investor has estimated the market rent for property, the vacancy rate, and operating expenses, they can calculate the potential net operating income that they can receive from the property. This estimate assumes that the space is rented at current market rents. You should already be familiar with the following simplified version of a financial analysis of any investment property:

\[
\begin{align*}
\text{PGI} & \quad \text{Potential Gross Income} \\
- \ V&C & \quad \text{Vacancy and Collection Losses} \\
+ \ OI & \quad \text{Other Income} \\
\text{EGI} & \quad \text{Effective Gross Income} \\
- \ OE & \quad \text{Operating Expenses (FE + VE + R)} \\
= \ NOI & \quad \text{Net Operating Income}
\end{align*}
\]

Example: Calculating the net operating income.

A property has a potential gross income (or PGI) of $45,000. The vacancy and collection (V&C) loss for the year was $4,000. There was no other miscellaneous income (OI). The property had operating expenses (OE) of $20,000. The net operating income for this property is $21,000.

\[
\begin{align*}
45,000 \quad & \text{PGI} \\
- \ 4,000 \quad & \text{V&C} \\
+ \ 0 \quad & \text{OI} \\
41,000 \quad & \text{EGI} \\
- \ 20,000 \quad & \text{OE} \\
21,000 \quad & \text{NOI}
\end{align*}
\]

Before-Tax Cash Flow (BTCF)

It is an investor’s goal for an investment property to yield a positive cash flow. Cash flow is equal to the cash received minus the cash paid out over a given period. Before-tax cash flow (BTCF) is the measure of the cash that is received after the net operating income has been calculated and any mortgage-related expenses are paid, but before taxes are taken into consideration.

Example: Calculating the before-tax cash flow (BTCF)

An investor has a property that has an NOI of $65,000 and mortgage expenses equal to $22,000. The investor’s before-tax cash flow is $43,000.

\[
\begin{align*}
65,000 \quad & \text{NOI} \\
- \ 22,000 \quad & \text{Mortgage expenses} \\
43,000 \quad & \text{BTCF}
\end{align*}
\]
After-Tax Cash Flow (ATCF)

The after-tax cash flow (ATCF) is the profit that the investor actually receives from income-producing property after the income taxes are paid. It is the before-tax cash flow, minus the tax liability.

- **Income tax liability.** An investor’s income tax liability from a property is based on taxable income rather than on cash flow. Taxable income is net operating income minus all allowable deductions, including the amount allowed for annual depreciation on the property (also referred to as cost recovery). Taxable income multiplied by the investor’s marginal tax bracket results in the investor’s tax liability.

\[
\text{NOI} - \text{Deductions} \quad \text{Allowable Deductions (Depreciation + Mortgage Interest)}
\]
\[
\text{Taxable Income} \quad \text{x} \quad \text{Tax Bracket} \quad \text{Marginal Tax Bracket}
\]
\[
\text{Tax Liability} \quad \text{Investor’s Income Tax Liability}
\]

**Example:** Calculating the income tax liability

If an investor has a taxable income of $35,000 and is in the 33% tax bracket, the tax liability for that investor will be $11,550.

\[
\begin{align*}
\text{\$35,000} & \quad \text{Taxable Income} \\
\times \quad 0.33 & \quad \text{Marginal Tax Bracket (33\% = 0.33)} \\
\text{\$11,550} & \quad \text{Income Tax Liability}
\end{align*}
\]

**Example:** Calculating the after-tax cash flow (ATCF)

As we said above, after-tax cash flow is before-tax cash flow minus tax liability. Therefore, if the investor above with the $11,550 tax liability had a before-tax cash flow of $43,000, the after-tax cash flow would be $31,450.

\[
\begin{align*}
\text{\$43,000} & \quad \text{BTCF} \\
\text{\$31,450} & \quad \text{ATCF}
\end{align*}
\]

REAL ESTATE TAXATION

You should have a basic understanding of the tax aspects of real estate transactions, since many clients will have questions regarding these issues. Investors rely on various tax benefits to help realize profit on their real estate investments. You should have some idea of when to recommend that a client seek the advice of a CPA to discuss the tax implications of a potential sale or investment.

Income Taxes in the U.S.

As you know, most Americans pay taxes on the money they earn. The *marginal tax rate* is the amount of tax paid on an additional dollar of income. This tax rate increases as income increases. Under a marginal tax rate, taxpayers are divided into tax brackets, or ranges. As income increases, what is earned will be taxed a higher rate than the first dollar earned. The tax bracket that applies to income ranges is called the *marginal tax bracket*. The current tax brackets are 10, 15, 25, 28, 33, 35, and 39.6%. 
In addition, the tax rates apply only to taxable income. Various adjustments and deductions, including the standard deduction and personal exemptions, all lower a person’s taxable income. *Taxable income* is usually less than a person’s total income.

**Real Estate Deductions and Exemptions**

The IRS allows certain real estate deductions and exemptions on an itemized income tax return.

- **Exemption for sale of primary residence.** The Taxpayer Relief Act of 1997 established new tax treatment for homeowners when the sale of a principal residence occurred. For taxpayers who are married, file their tax return jointly, and who have owned and used the property as a principal residence for at least two of the previous five years prior to sale, the law exempts the first $500,000 gained from the sale. Single homeowners can exclude up to $250,000 in gains from taxation.

- **Property tax deduction.** State and local property taxes can be deducted as an expense against the owner’s income; however, the real estate taxes are only deductible in the year in which they are actually paid to the government. Taxes on non-income property are included as itemized deductions on Schedule A of the personal return. Deductions for investment property are taken on Schedule E, which is a special schedule for that purpose. Property taxes can be deducted for any or all of the following:
  - Personal residence
  - Second home
  - Time-share property
  - Vacant lot or land
  - Income property
  - Inherited property

- **Mortgage interest deduction.** A mortgage interest deduction is allowed on a qualified home, namely the main or second home. That home may be a house, condominium, cooperative, mobile home, house trailer, or boat that has sleeping, cooking, and toilet facilities. The homeowner can usually deduct all of the mortgage interest as long as they itemize the deductions and are legally liable for the loan. A person cannot deduct interest on payments they make on someone else’s loan. Interest paid on a mortgage that is not the primary or second home may be deductible if the loan proceeds are for business, investment, or other deductible uses. If not, the interest would be considered personal and cannot be deducted.

**Basis of Property**

*Basis* is the amount of the investment in property for tax purposes. The basis is used to determine gain or loss on the sale, exchange, or other disposition of property. Basis is also used to figure deductions for depreciation, amortization, depletion, and casualty losses.

The original basis in property is adjusted (increased or decreased) by certain events. For example, the basis is increased if improvements are made to the property. The basis is reduced if deductions are taken for depreciation or casualty losses, or if certain credits are claimed.
The seller of a principal residence may owe tax on any capital gain resulting from the sale of his or her home. The IRS defines gain on the sale of a home as the amount realized from the sale minus the adjusted basis of the home sold.

- **Cost basis.** The *cost basis* for property is usually its initial cost. The cost basis is the amount paid in cash, debt obligations, other property, or services to purchase the property. The cost basis also includes other settlement costs such as legal and recording fees, utility installation charges, transfer taxes, and owner’s title insurance. Any amounts the seller owes that the buyer agrees to pay, such as back taxes or interest, recording or mortgage fees, charges for improvements or repairs, and sales commission may also be included in the cost basis.

  The costs basis does not include the following items:
  
  - Amounts placed in escrow for future payments, such as taxes and insurance
  - Casualty insurance premiums
  - Rent or utility charges for occupancy of the property before closing
  - Charges connected with getting a loan, such as points, mortgage insurance premiums, assumption fees, cost of a credit report, and fees for an appraisal required by a lender
  - Fees for refinancing a mortgage

- **Adjusted basis.** *Adjusted basis* is a measurement of how much is invested in the property for tax purposes. When a property is purchased, the *beginning basis* is the cost of acquiring the property. The beginning basis is increased or decreased by certain types of expenditures made while the property is owned. The result is the adjusted basis.

  Basis is increased by the cost of capital improvements made to the property, assessments for local improvements, casualty losses such as restoring damaged property, certain legal fees, and zoning costs. Assessments for local improvements such as water connections, extending utility service lines to the property, roads, and sidewalks also increase the basis. Increases include costs of any improvements having a useful life of more than 1 year. Examples of capital improvements include:

  - Putting an addition on the home
  - Paving the driveway
  - Replacing an entire roof
  - Installing central air conditioning
  - Rewiring the home

  Basis is decreased by any items that represent a return of capital for the period during which the property is held. Decreases include depreciation and casualty losses. Examples of decreases include:

  - Exclusions from income of subsidies for energy conservation measures
  - Casualty or theft loss deductions and insurance reimbursements
  - Postponed gain from the sale of a primary home when acquiring this home
  - Residential energy credits
  - Depreciation
  - Amount received for granting an easement
The basic formula for adjusted basis is:

**Adjusted basis = Initial Cost Basis + Increases - Decreases**

**Example:** Calculating the adjusted basis

Larry and Mary originally paid $100,000 for their home. They spent an additional $5,000 on a new central heating and cooling unit. Their adjusted basis at the time of selling it is $105,000.

\[
\begin{align*}
$100,000 & \quad \text{Beginning Basis} \\
+ 5,000 & \quad \text{Capital Improvements} \\
= 105,000 & \quad \text{Adjusted Basis}
\end{align*}
\]

**Example:** Sample calculation of adjusted basis from the IRS

A duplex used as rental property originally cost $40,000, of which $35,000 was allocated to the building and $5,000 to the land. An improvement was added to the duplex that cost $10,000. In February last year, the duplex was damaged by fire. Up to that time, $23,000 had been allowed for depreciation.

The owner sold some salvaged material for $1,300 and collected $19,700 from the insurance company. They deducted a casualty loss of $1,000 on their income tax return for last year.

The owner spent $19,000 of the insurance proceeds for restoration of the duplex, which was completed this year. The duplex's adjusted basis after the restoration will be used to determine depreciation for the rest of the property's recovery period. Figure the adjusted basis of the duplex as follows:

<table>
<thead>
<tr>
<th>Amount realized. The <em>amount realized</em>, also known as <em>net proceeds from sale</em>, is expressed by this formula:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Amount Realized = Sale Price – Costs of Sale</strong></td>
</tr>
<tr>
<td>The <em>sale price</em> is the total amount the seller receives for the home including money, notes, mortgages, or other debts the buyer assumes as part of the sale. The <em>costs of sale</em> include brokerage commissions, relevant advertising, legal fees, seller-paid points, and other closing costs paid by the seller.</td>
</tr>
</tbody>
</table>
Example: Calculating the amount realized

Larry and Mary sold their home for $175,000. Their selling costs, including the commission they paid Broker Betty and amounts paid to inspectors, a surveyor, and the title company, amounted to 10% of the selling price, or $17,500. The amount they realized from the sale was $157,500.

<table>
<thead>
<tr>
<th>Sale Price</th>
<th>Costs of Sale</th>
<th>Amount Realized</th>
</tr>
</thead>
<tbody>
<tr>
<td>$175,000</td>
<td>- 17,500</td>
<td>$157,500</td>
</tr>
</tbody>
</table>

Capital Gains and Losses

Gain or loss is usually realized when property is sold or exchanged. Capital gains and losses are classified as long-term or short-term, depending on how long the property is held before it is sold. If the property is held more than one year, the capital gain or loss is long-term. If the property is held one year or less, the capital gain or loss is short-term. If capital assets such as stocks, collectibles, or real property are held for longer than a year, any profits on the sale are taxed at a reduced rate.

Capital Gains

A capital gain is the amount realized from the sale or exchange of property that is more than its adjusted basis. A realized capital gain is an investment that has been sold at a profit. An unrealized capital gain is the potential gain on an investment if it were to be sold. For most investments sold at a profit, the individual will owe the IRS capital gains tax.

The gain on the sale of a primary residence is represented by the basic formula:

\[
\text{Gain} = \text{Amount Realized} - \text{Adjusted Basis}
\]

Example: Calculating the gain on sale

Using the simple examples above for Larry and Mary in the previous section, the gain on the sale would be calculated as follows:

<table>
<thead>
<tr>
<th>Sale Price</th>
<th>Costs of Sale</th>
<th>Amount Realized</th>
</tr>
</thead>
<tbody>
<tr>
<td>$175,000</td>
<td>- 17,500</td>
<td>$157,500</td>
</tr>
<tr>
<td>$100,000</td>
<td>+ 5,000</td>
<td>$105,000</td>
</tr>
<tr>
<td>$157,500</td>
<td></td>
<td>$52,500</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Beginning Basis (of old home)</th>
<th>Capital Improvements</th>
<th>Adjusted Basis (of old home)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100,000</td>
<td>5,000</td>
<td>$105,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Amount Realized</th>
<th>Adjusted Basis</th>
<th>Gain on Sale</th>
</tr>
</thead>
<tbody>
<tr>
<td>$157,500</td>
<td>$105,000</td>
<td>$52,500</td>
</tr>
</tbody>
</table>
In the case of Larry and Mary, their capital gain was $52,500. However, they will not owe tax on this amount in the year in which they sell their home because they qualify for the Taxpayer Relief Act’s $500,000 exclusion for married couples who file their tax return jointly.

Different types of income are taxed at different rates. Most taxpayers pay income tax at their marginal tax rate. Income from some investments may be tax-deferred. Other income may be taxed at a lower rate. The gain on the sale, if it does not qualify for exclusion under current tax law, is taxable.

The tax rates that apply to net capital gain are generally lower than the tax rates that apply to other income. A summary of the current capital gain tax rates for taxable income ranges follows:

<table>
<thead>
<tr>
<th>Single Taxpayer</th>
<th>Married Filing Jointly</th>
<th>Capital Gain Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 - $36,250</td>
<td>$0 - $72,500</td>
<td>0%</td>
</tr>
<tr>
<td>$36,251 - $400,000</td>
<td>$72,501 - $450,000</td>
<td>15%</td>
</tr>
<tr>
<td>$400,001 +</td>
<td>$450,001 +</td>
<td>20%</td>
</tr>
</tbody>
</table>

**Capital Losses**

A capital loss is the adjusted basis of the property that is more than the amount realized from the sale or exchange. An individual has a capital loss if they sell an asset for less than the purchase price. Capital losses can reduce capital gains.

Capital losses may only be deducted on investment property, not on property held for personal use. If the capital losses exceed the capital gains, the excess can be deducted on the tax return and used to reduce other income, such as wages, up to an annual limit of $3,000, or $1,500 if married filing separately.

**Gains and Losses on Investment Property**

Similar to the sale of a primary residence, the gain on an investment property is the amount realized that is more than the property’s adjusted basis. If the long-term gains are in excess of the long-term losses, there is a net capital gain.

**How to Figure Whether You Have a Gain or Loss**

<table>
<thead>
<tr>
<th>IF the...</th>
<th>THEN there is a...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted basis is more than the amount realized,</td>
<td>Loss.</td>
</tr>
<tr>
<td>Amount realized is more than the adjusted basis,</td>
<td>Gain.</td>
</tr>
</tbody>
</table>
Example: Calculating gain on investment property

On June 20, 2010, Gary purchased an apartment building on the following terms:
$100,000 in cash at closing, with Gary taking the title subject to an existing mortgage
note, which had a remaining balance of $400,000. Gary also signed a note and
second mortgage for $50,000. He paid $5,000 into a property tax and insurance
escrow account, and paid $300 for the seller’s prepaid water bill, $800 for heating oil
that remained in the building’s tanks, and $50 for document recording. He also paid
$1,500 for legal representation, $300 for an owner’s title insurance policy, $475 for a
lender’s title insurance policy and $180 for a credit report. Gary’s initial tax basis is
$551,850.

\[
\begin{align*}
$100,000 & \text{ Cash Down Payment} \\
+ 450,000 & \text{ First Mortgage ($400,000) + Second Mortgage ($50,000)} \\
$550,000 & \text{ Purchase Price} \\
$550,000 & \text{ Purchase Price} \\
+ 1,850 & \text{ Attorney ($1,500) + Title Policy ($300) + Recording Fee ($50)} \\
$551,850 & \text{ Beginning Basis}
\end{align*}
\]

Note: All the other money Gary paid out represents his costs of obtaining
financing or is incidental to the purchase and cannot be included in the calculation of
the beginning basis.

Gary sold his property on December 2, 2013, for $970,500. While he held the
property, he made $50,000 in capital improvements and was able to take $70,000 in
depreciation. He also paid selling expenses of $25,000. Gary’s gain on the sale is
$463,650.

\[
\begin{align*}
$551,850 & \text{ Beginning Basis} \\
+ 50,000 & \text{ Capital Improvements} \\
$601,850 & \text{ } \\
- 95,000 & \text{ Depreciation ($70,000) + Costs of Sale ($25,000)} \\
$506,850 & \text{ Adjusted Basis} \\
$970,500 & \text{ Amount Realized} \\
- 506,850 & \text{ Adjusted Basis} \\
$463,650 & \text{ Gain on Sale}
\end{align*}
\]

Depreciation

Depreciation means the reduction in the value of an asset due to usage, passage of
time, wear and tear, technological outdating or obsolescence, depletion, or other such
factors.

Tax depreciation is a deduction that allows an investor to write off the cost of his or
her investment in income-producing property over a prescribed period. The recoupment
of the purchase price of the property through depreciation is known as cost recovery.

For tax purposes, depreciation is computed by using the Modified Accelerated Cost
Recovery System (MACRS). The MACRS stipulates the time periods over which
investment real estate can be depreciated for tax purposes. The time period begins
when the property is placed in service, which, essentially, means the time in which title is
taken.
Tax law currently allows the owners of residential and low-income investment properties to depreciate a portion of their investment over 27.5 years on a *straight-line basis*. The residential category includes single-family rentals, all apartment rentals, and mobile homes. The owners of nonresidential investment properties may depreciate a portion of their investment over 39 years, also on a straight-line basis. Hotels and motels are classified as nonresidential.

To calculate the amount of the allowable deduction, the total cost of acquisition, including the total cost of the property plus closing costs, is allocated on a percentage basis to the land and improvements. The basis for depreciation is that portion of the total cost, including closing costs, which applies to the improvements. Land cannot be depreciated. This amount is evenly divided by the number of years allowed, either 27.5 or 39, depending on the type of property. That is what is meant by straight-line; the same dollar amount is deducted each year. This percentage can be calculated by having an appraisal made or using the percentages of land and improvements utilized by the property appraiser’s office. The basis is reduced each year by the amount allowed until the total depreciable basis equals zero or the property is sold.

**Example**: Calculating depreciation

An investor owns a single-family residence that he rents out. The home cost $150,000 and the land is worth $40,000, leaving an improvement value of $110,000. If the investor divides the $110,000 by 27.5 years, he will have a depreciation figure of $3,636.36 per year. Therefore, he can deduct $4,000 per year for depreciation on this property.

\[
\begin{align*}
\text{Home Cost} & = \$150,000 \\
\text{Land Value} & = - \$40,000 \\
\text{Improvement Value} & = \$110,000
\end{align*}
\]

$110,000 Improvement Value ÷ 27.5 Years = $4,000 Depreciation

When an investor sells a depreciable asset, the depreciated value is used to compute the taxable gain on the sale.

**Example**: Calculating the taxable gain by using the depreciated value

Let’s use our previous example of Gary’s apartment building.

\[
\begin{align*}
\text{Beginning Basis} & = \$551,850 \\
\text{Depreciation} & = - \$70,000 \\
\text{Adjusted Basis} & = \$481,850 \\
\text{Sale Price} & = \$970,500 \\
\text{Adjusted Basis} & = - \$481,850 \\
\text{Taxable Gain on the depreciated property} & = \$488,650
\end{align*}
\]

Therefore, the basis of a depreciable asset is reduced by any depreciation the property owner took during the time they held the property.

The above example is a simplified calculation. It did not take into account any improvements Gary made to the property or any other expenses he may be eligible to deduct to arrive at his final taxable gain on the sale.
**Note:** Tax depreciation is an accounting concept only – taken on paper. In reality, the property that is being depreciated may actually appreciate in value. Appreciation refers to the increase in value of an asset over time. When a property sells, the investor may have to pay tax on the real appreciation and the recapture of the artificial tax depreciation.

**Tax Shelter**

A *tax shelter* is any investment that is designed to reduce or avoid income taxes. In real estate investment, as a property appreciates in value, the investor is allowed a paper deduction for depreciation. Mortgage interest is also a deductible allowance.

**Example:** Calculating a tax shelter

Investor Diane purchases an income-producing property that provides a tax shelter. In the first year, the property produces a net operating income of $300,000. The mortgage payments on the property are $90,000, of which $80,000 is interest. The first-year depreciation on the property is $75,000, which reduces the taxable income considerably.

$300,000 Net Operating Income
- 155,000 Interest ($80,000) + Depreciation ($75,000) Deductions
$145,000 Taxable Income

Sometimes, the allowable deductions can result in a loss, especially in the early years of the investment. These non-cash losses can be deducted from income to reduce the investor’s tax liability.

**Example:** Deductions resulting in a loss

Investor Rich’s income-producing property produces a net operating income of $100,000 in the first year. The mortgage payments on the property are $80,000, of which $75,000 is interest. Rich’s before-tax cash flow (BTCF) is $20,000. However, the first-year depreciation on the property is $50,000, which generates a tax loss as shown below.

$100,000 Net Operating Income
- 125,000 Interest ($75,000) + Depreciation ($50,000) Deductions
($25,000) Taxable Income (Loss)

Rich not only pays no tax on the $20,000 cash flow, but he might be allowed to shelter $25,000 of income from other sources.

**Property Exchange**

If an investor participates in an exchange of a like-kind asset, any taxable gain or tax-deductible loss is not recognized in the year the transaction takes place. Rather, the investor can defer those gains or losses, until a future taxable transaction occurs involving a substitute property. Like-kind property exchanges are sometimes wrongly called *tax-free exchanges*. They are not tax-free; they are tax deferred.
The legislation that deals with like-kind exchanges is contained in Section 1031 of the IRS code. Because of this, these exchanges are sometimes called Section 1031 exchanges. To qualify under Section 1031, there must be a legitimate exchange of the assets involved. Therefore, it is important for investors to make certain that all proper steps are taken by all parties involved in the transaction so the transaction can be documented as a bona fide exchange.

To qualify as a like-kind exchange, the property being transferred must have been held for productive use in a trade or business or held as an investment and must be exchanged for property that will also be used in a trade or business or be held as an investment. Qualifying properties can fall into either of these categories. In other words, a property that is used in a trade or business may be exchanged for an investment property and vice versa. This is also known as a tax-deferred exchange.

Properties that are eligible for like-kind exchange include:

- Apartments and residential rentals
- Commercial property
- Industrial property
- Farms
- Leaseholds greater than 30 years
- Unimproved land (non-dealer held property)
- Hotels or motels

The properties must be like-kind in nature or character, not in use, quality, or grade. Real estate investors must realize that one property can be exchanged for another property regardless of the property type, as long as it is held as an investment or for use in a trade or business. In addition, a single property can be exchanged for several properties. Here are some examples:

- Trade or business property, together with cash, for other trade or business property
- Metropolitan property for a farm or ranch
- Improved investment property for unimproved investment property
- A leasehold, with for at least 30 years to run, for a freehold
- Mineral interest in land to for a fee title in real estate

Note: Property in the United States and property in foreign countries are not considered like-kind under Section 1031.

**Taxable Gain on an Exchange**

An exchange is tax-deferred if there is a straight trade, meaning that a property is exchanged for one of equal value. However, often that is not the case. If the properties are not of equal value, one party may receive cash or mortgage relief to equalize the transaction. Any cash or relief one party receives in addition to the actual property is called boot. The person who receives the boot has a net gain and must pay taxes on it. In a situation like this, the exchange is not fully tax-deferred, only partially so.

Exchanges are particularly popular among investors who own apartment buildings and commercial real estate. Many of these owners are already in high income tax brackets, so exchanging gives them the opportunity to acquire more valuable property without the high tax consequences. They can keep their money invested in real estate holdings by rolling over the properties, which mimics selling and buying at the same time.
WORKING WITH INVESTMENT PROPERTY

If you are interested in pursuing opportunities in the real estate investment arena, then you should arm yourself with additional knowledge by taking commercial real estate seminars as well as investment and property management classes that are available. In addition, the CCIM (Certified Commercial Investment Member) designation is available through the CCIM Institute. You can earn the CCIM designation by completing a curriculum that covers market analysis, property analysis, financial analysis, decision analysis, negotiation, and ethics. A CCIM has to demonstrate a completed portfolio of commercial real estate experience and successfully pass a comprehensive examination.

For more information on the CCIM, please visit the CCIM Institute Web site at www.ccim.com.
CHAPTER 12 REVIEW QUESTIONS

1. The three main characteristics of investment property that must be weighed in an investment decision are ____________, ____________, and ____________. ____________ is the chance of experiencing a loss. A greater chance of experiencing a loss typically results in a greater potential ____________ on the investment.

2. A ______ asset can be sold rapidly, with minimal loss of value, anytime within market hours. An ______ asset is one which is not readily saleable. Cash is the most ______ asset. Property is considered an ______ asset.

3. ____________ is the use of borrowed funds to increase the potential return of an investment. The ratio of the amount borrowed to the financed property market value is the ____________ ratio.

4. There are many types of investment properties. (1) ____________ can be multi- or single-tenant buildings that vary in size and location. (2) ____________ property is usually purchased to _____ (for appreciation over time) or to _____ (to sell quickly for a profit). (3) ____________ property includes malls. (4) ____________ property includes warehouses and manufacturing facilities.

5. ____________ in the purchase of an investment property includes a market analysis, which consists of an analysis of ____________ concerns, ____________ regulations, and a ____________ profile.

6. Net operating income (NOI) is the term that describes the income produced by a specific property after all ____________ have been deducted from the ____________.

7. Operating expenses include ______ expenses, ______ expenses, and ____________.

8. ____________ is equal to the cash received minus the cash paid out over a given period. An investor’s goal is to yield a ____________.

9. The ____________ is equal to the net operating income (NOI) minus mortgage expenses, before taxes. The ____________ is the profit that the investor actually receives from income-producing property after the income taxes are paid.

10. The tax rate that applies to various ranges of income is called the ____________.

11. Tax rates only apply to ____________, which is usually _____ than a person’s total income due to various deductions and exemptions.

12. ______ is the amount of the investment in property for tax purposes and is used to determine gain or loss upon sale. The ____________ for property is usually its initial cost. The ____________ is a measurement of how much is invested in the property for tax purposes, and is determined by increasing or decreasing the ____________ for certain types of expenditures.

13. A capital gain is the amount realized by the sale of property that is more than its ____________. A ______ capital gain is an investment that was sold at a profit. An ______ capital gain is the potential gain if it were to be sold. ____________ can reduce capital gains.

14. ______ is a tax deduction used by investors to write off investment costs over a period of time on a ____________: _____ years for residential property and ____ years for non-residential property.

15. ______ of the IRS code deals with like-kind exchanges, allowing an investor to _____ the taxation of gains or losses. The properties must be for investment use or use in a trade or business.
CHAPTER 12 PRACTICE EXAM

1. Which of the following methods is NOT used by a person to realize profits from a real estate investment?
   a. Tax benefits
   b. Positive cash flow
   c. Negative amortization
   d. Appreciation

2. Which property exchange would definitely NOT be eligible for a like-kind 1031 exchange?
   a. An apartment building in New York with a like-kind apartment building in Toronto
   b. A business property in Atlanta, GA together with cash for a business property in Gainesville, FL
   c. An investment property in Miami, FL for a farm in Ocala, FL
   d. Improved investment property for unimproved investment property where both properties are in Tallahassee, FL

3. Unimproved land is considered the riskiest type of investment property. Which factor does NOT contribute to this risk?
   a. No management costs
   b. Negative cash flow
   c. No depreciation benefits from property improvements
   d. Unexpected adverse effects from zoning changes or building restrictions

4. Which term refers to an investment that has been sold at a profit?
   a. Adjusted basis
   b. Amount realized
   c. Realized capital gain
   d. Unrealized capital gain

5. Due diligence is the collective term given to the data gathering and analysis step that is critical to making a real estate investment decision. Which of the following would NOT be included in this due diligence?
   a. Market analysis
   b. Property analysis
   c. Financial analysis
   d. Capital gain/loss analysis

6. What is the purpose of a tax shelter in real estate investment?
   a. To increase the rate on capital gains
   b. To reduce or avoid income taxes through tax deductions and depreciation
   c. To hide income from the IRS
   d. To off-load the tax liability to a third party

7. What is the term given to the profit that the investor actually receives from income-producing property after the income taxes are paid?
   a. Before-tax cash flow
   b. After-tax cash flow
   c. Net operating income
   d. Tax basis

8. An investor’s rate of return on an investment exceeds the cost of borrowing. What term best describes this situation?
   a. Capital gain
   b. Capital loss
   c. Positive leverage
   d. Negative leverage

9. Which type of investment property would typically be best suited for “flipping”?
   a. An occupied high-rise office building
   b. A residential “fixer-upper”
   c. A new apartment building
   d. An industrial warehouse facility

10. Which measurement value is NOT used to determine an investor’s net operating income (NOI)?
    a. Market rent
    b. Vacancy and collection loss
    c. Operating expenses
    d. Debt service
11. The IRS allows certain real estate deductions and exemptions on an itemized return. Which item is NOT allowable?
   a. Exempt first $250,000 (if single) gained in the sale of a primary residence owned for 6 years; $500,000 if married filing jointly
   b. Deduct mortgage interest paid on a family member’s primary home loan
   c. Deduct property tax paid in the year of the deduction for income property
   d. Deduct mortgage interest on a primary home

12. The adjusted basis is a measurement of how much is invested in a property for tax purposes. Which item decreases the adjusted basis?
   a. Roof replacement
   b. Assessment for road widening
   c. Restoration of damaged property
   d. Depreciation

13. What is the time period established by the IRS over which nonresidential investment real estate can be depreciated?
   a. 39 years
   b. 27.5 years
   c. 22 years
   d. As long as the investor holds the property

14. What does the term “liquidity” refer to in the real estate market?
   a. The ability to reduce investment expenses while increasing income
   b. The flow and balance of income and expenses for an investment property
   c. The range of investments based on existing market segment holdings
   d. The speed or degree to which property can be sold in the market without affecting the price

15. After holding a property for ten months, investor Sally sold a low-rise office complex for a profit of $24,000. What is the term that best describes her profit?
   a. Long-term gain
   b. Extended-term gain
   c. Short-term gain
   d. Protracted-term gain
OVERVIEW

Becoming a licensed real estate broker who works for a brokerage company is one thing. Owning and managing a real estate firm is something altogether different. Making the decision to start your own brokerage firm is a big step and one that needs careful consideration and planning. A broker has several responsibilities. They must be an effective salesperson, a business manager, a financial analyst, a marketer, a personnel manager, and a leader. In addition, to being able to run a successful business, they must be very knowledgeable of the real estate law.

Many times, successful sales people want to become managing brokers and have their own brokerage business, only to discover how truly difficult it is. For that reason, in this chapter, we cover some of the topics that a prospective brokerage company owner must face when going into business.

OBJECTIVES

After completing this chapter, you should be able to do all of the following:

- Identify the various real estate specialties and forms of organization
- Discuss a number of business models from which a broker can choose
- Explain the important aspects to consider in a good business plan
- Discuss recruiting practices and the training of associates
- Know the qualities to look for and the traits to avoid in an office manager

BUSINESS PLANNING

Are you thinking about becoming a broker? If you are, that probably means you have been successful as a sales associate and are considering taking your business to the next level and striking out on your own. One thing is certain, the opportunities are endless, and the potential for growth is substantial.

The move to broker is a big decision and requires substantial planning. Henry Wadsworth Longfellow said, “It takes less time to do a thing right, than it does to explain why you did it wrong.” That certainly applies here. You’ll need to look carefully at a number of matters to help plan your best course of action.

Two fundamental considerations to getting started are the area of specialty for your business and the form of your organization.

Specialties

Just as there are possible areas of specialty for sales associates, there are also several brokerage specialties from which to choose as your basis. This does not mean
that you are locked into only that particular type of real estate, but, in most successful
brokerage operations, the majority of business comes from a single specialty.

- **Business brokerage.** *Business brokerage* specializes in helping small business
owners in the buying and selling process. Business brokers typically estimate the
value of the business; advertise it for sale with or without disclosing its identity;
handle the initial potential buyer interviews, discussions, and negotiations with
prospective buyers; facilitate the progress of the due diligence investigation, and
generally assist with the business sale.

- **Commercial brokerage.** *Commercial brokerage* specializes in selling or leasing
income-producing properties such as malls, office parks, restaurants, gas
stations, convenience stores, and office towers. The businesses that occupy
commercial real estate usually lease the space. An investor usually owns the
building and collects rent from each business that operates there.

- **Residential brokerage.** *Residential brokerage* specializes in selling homes,
condominiums, cooperatives, and other properties designed to be used as living
space.

- **Industrial brokerage.** *Industrial brokerage* specializes in selling or leasing
property used for industrial purposes. This includes factory-office multiuse
property, factory-warehouse multiuse property, heavy manufacturing buildings,
industrial parks, light manufacturing buildings, and research and development
parks.

- **Property management.** *Property management* specializes in managing different
types of property owned by others. The property manager acts on behalf of the
owner to maintain the property’s value while generating income. The manager is
typically paid a fee and/or a percentage of the generated income while the
management contract is in force. Managed properties can be residential,
commercial, or industrial.

### Forms of Organization

Several forms of organization can accommodate ownership by one or several
individuals or entities. Sole proprietorship, partnership, and corporation are examples of
different forms of organization. A brokerage business can also be franchised or
independent.

The different forms of ownership have a number of legal and tax implications. You
should always consult with an attorney and a tax professional before making a decision.

### Sole Proprietorship

A **sole proprietorship** is a business formed by an
individual. The individual is personally liable for his or
her actions, and can be sued individually. A sole
proprietor is also liable for the acts of his or her
employees when the acts are within the scope of the
employee’s employment.

A **sole proprietor broker** can register and operate as
a real estate broker if he or she has a current active
and valid broker’s license. A broker can operate in his or her personal name or under a
trade name. [F.A.C. 61J2-10.034]
Partnership

The principal characteristic of a partnership is that each partner is personally liable for the partnership business and, therefore, may be sued individually. The acts of one partner within the scope of the partnership business are also binding on other partners whether they knew about or took part in the acts or not. Partners are jointly (together) and severally (individually) liable for all debts and liabilities of the partnership. If a partnership is sued, the partners are named personally and as partners of the partnership.

A real estate brokerage partnership must have at least one partner licensed as an active broker. A broker with an inactive license and an unlicensed person can be partners, but cannot perform real estate services. However, they must register with the Department. All partners, who provide real estate services to the public either directly or indirectly, must hold an active broker’s license. A sales associate or broker associate cannot be a partner in a real estate brokerage partnership. [F.A.C. 61J2-4.007 and 61J2-5.016]

A real estate brokerage partnership must be registered with the Department in the name of the partnership. [F.S. 475.15]

In the event that a partnership has only one active broker, and the broker dies or resigns, the vacancy must be filled within 14 calendar days. During this time period, the partnership may conclude any business that was already in progress, but may not acquire any new brokerage business. No new business may be performed until a new active broker is appointed and registered. Failure of the partnership to appoint another active broker within the 14-day period will result in cancellation of the partnership registration. The real estate licenses of all partners and sales associates will automatically change to inactive status.

Corporation

A real estate brokerage corporation must provide proof of legal corporate existence prior to its initial registration with the Department. The corporation and the names of all officers and directors of the corporation must be registered with the Department to perform real estate services for others. At least one corporate officer must have an active real estate broker’s license. [F.S. 475.15] [F.A.C. 61J2-5.012 and 61J2-5.014]

In the event that a corporation has only one active broker, and the broker dies, resigns, or is otherwise removed from the position, the vacancy must be filled within 14 calendar days. During this time period, the corporation may not acquire any new brokerage business but may conclude existing business. No new brokerage business may be acquired until a new active broker is appointed and registered. Failure of the corporation to appoint another active broker within the 14-day period will result in cancellation of the corporate registration. Additionally, the real estate licenses of corporate officers, directors, and sales associates will automatically be placed in an involuntarily inactive status.

However, if the corporation has more than one active registered broker, neither the corporate registration nor the real estate license of any corporate officer, director, or sales associate will be affected by the vacancy. [F.A.C. 61J2-5.018]
All corporate officers and directors, who provide real estate services to the public either directly or indirectly, must hold an active real estate broker’s license. Brokers who have an inactive license and unlicensed persons who serve as corporate officers or directors may not perform real estate services, but must be registered with the Department. A sales associate or broker associate may not be an officer or director in a real estate brokerage corporation. Anyone can be a stockholder whether they are licensed or not. [F.S. 475.15] [F.A.C. 61J2-4.007, 61J2-5.015, and 61J2-5.016]

Franchise vs. Independent

- **Franchise.** A *franchise* is a business structure with a parent and franchised smaller subsidiary operations. A franchise can offer considerable advantages for the new broker, such as the established name recognition, proven business model, start-up and ongoing support, and training.

  In addition, a franchise also offers national advertising as well as local advertising opportunities by combining your efforts with other franchise owners for collective purchases. A franchise has the immediate effect of creating an established, prosperous image for the new broker.

  Of course, all of this comes with several fees. There is an up-front cost of purchasing the franchise and the ongoing cost of franchise fees. Most franchise fees are based on a percentage of sales.

- **Independent.** By opening an *independent* firm, you save money in the beginning as compared to opening a franchise where you have the cost of purchasing the franchise or the ongoing franchise fees. Of course, you give up all the advantages of a franchise, however, the challenge of creating your own brand from the ground up can be extremely rewarding. It requires your vision, a strong business plan, and a lot of sweat equity on your part. Once you know your market and carve out your niche, the potential is limitless.

The Business Model

Over the past several years, various business models have emerged in real estate brokerage operations. One of the biggest decisions you face as a new broker is what your office business model will be. There are several options.

Traditional/Full-Service Model

With the *traditional/full-service model*, the broker provides substantial support services for the associates in the office. Associates are typically hired at an entry-level commission split of 50% to 60%. The commission is on a graduated scale and increases for the associate as their production increases. The broker provides various support services to enhance and support associate production.
Services that a broker might provide in traditional/full service model include:

- Desk/office
- Phone
- Fax
- Copy machine
- Internet access
- Advertising (newspapers, magazines, etc.)
- Postcards (just listed, just sold)
- Postage for direct mail
- Sales training
- Property flyers
- Company or personal website
- Listing presentations and forms software
- In-house mortgage services
- Fulltime receptionist
- Referral services
- For sale signs
- Internet access
- Fulltime receptionist
- Sales training
- Property flyers
- Company or personal website
- Listing presentations and forms software
- In-house mortgage services
- Fulltime receptionist
- Referral services
- For sale signs

The traditional/full-service model has declined in recent years. With associates requiring larger commission splits and the competition from other business models, the profit margins for the broker have declined. Many brokers have been forced to reduce resources in return for paying higher commission splits.

**Reduced Service/Higher Commission Model**

The reduced service/higher commission model has been gaining in popularity. As many brokers have been forced to scale back the support they provide to their associates, they have increased the commission splits. Brand new associates with little or no experience are brought in at a 70% to 75% commission level with the ability to move higher with production.

The broker provides some services such as:

- Desk
- Phone
- Fax
- Copy machine
- Internet access
- Fulltime receptionist
- Consultations, when needed

The responsibilities of the associate include:

- All advertising (newspaper, magazine, etc.)
- Direct mail postage
- Property flyers
- Personal website
- Listing presentation and forms software
With the reduced service/higher commission business model, some brokers might charge a small monthly desk fee or marketing fee to the associate. This model tends to be a compromise between the traditional/full-service model and the high commission/100% commission model.

High or 100% Commission Model

The high or 100% commission model has gained in numbers and seems to be growing. The broker pays an extremely high commission split to all associates, new and experienced. Commissions to the associate are 95% to 100%. The broker usually charges a monthly desk fee to the associate and a small fee for every closing, around $395 or so. The desk fee is due and payable every month whether the associate closes a transaction or not. The broker provides little or no support to the associate.

Under this model, the number of associates is the defining factor. The broker’s earnings are generated through the monthly fees paid by the associate. Therefore, the more associates, the more revenue for the broker. For the broker it is all about recruiting associates rather than producing sales.

Broker Sells/No Associates Model

The broker sells/no associates model is an option in which the broker makes the business decision to run a one-man office and not hire associates. In this model, the broker usually maintains a home office or virtual office with a postal address. Home offices are legal in Florida, but the broker must comply with all required office requirements including a sign.

Virtual Office Website (VOW)

The virtual office website (VOW) model is like a traditional office, except it operates exclusively online. The public visits the VOW and registers by providing personal information. In doing so, the visitor becomes a registered client of the broker. The client is now able to do property searches through the MLS and access other information provided on the VOW.

To read the NAR policy on virtual office websites, please visit the NAR Web site at www.realtor.org.
THE BUSINESS PLAN

In order to formulate a business plan, you should ask yourself these questions.

To ensure your success, a good business plan is necessary right from the beginning. The first rule of an effective business plan is to put it in writing. It doesn’t have to consist of a large number of pages and be so detailed as to discuss the color of the interior paint, but it does need to cover all the important aspects for getting started. You can prepare a more detailed, long-range plan after the business is up and running.

In this section, we will discuss the following important steps in formulating your business plan:

- Define your role
- Define your market
- Plan your office space (facility)
- Determine start-up costs
- Prepare your operating budget
- Compose a policy and procedures manual
- Establish your brand

Define Your Role

It’s important to define the operating business model of your brokerage operation and your role in it. Your business model will dictate the size and location of your office as well as the staff required to run it.

Decide what your personal role, as broker, will be. Will you be a selling broker or focus strictly on management, or perhaps both?

As a selling broker, there are two things to consider:

- You will be competing with your own associates and this can create problems. It may also be an issue in recruiting new associates to the office. From the associates’ point of view, it will not be considered a plus to be in competition with the broker. For example, the associates may feel the broker is keeping all the good referrals and cutting them out.

- As a selling broker, you will have less time for management duties and may require a fulltime office manager.
Define Your Market

Know your market area and demographics. Define your niche. Don’t guess; do your homework. Things to consider are:

- Volume of sales
- Average sale price
- Time on the market
- Age of the sellers
- Turnover rate/rate of sale
- Age of the buyers
- Where the buyers come from
- Competition

There are numerous sources where you can find this information, such as:

- The MLS provides home sales statistics.
- Florida REALTORS® supplies buyer studies, seller studies, and marketing studies.
- National Association of REALTORS® provides market studies, seller/buyer marketing, and advertising
- The United States Census Bureau provides information on demographics, age, income, and profession.

PLAN YOUR OFFICE SPACE (FACILITY)

Making the move from your little office cubicle to an entire building or leased space is a big leap. You need to give serious thought to exactly how much space you need and the cost involved. For most brokers, the single biggest expense is office space. Things to consider when planning your space are listed on the following page.
As we mentioned earlier, it is legal in Florida to operate a real estate brokerage office out of your home, zoning permitting. The operation of the office cannot be in violation of any local zoning laws or homeowner or condominium association rules and it must comply with the Americans with Disabilities Act.

In addition, even if the office is in a private residence, it must still comply with all laws, which govern a real estate office including signage and brokerage audits by the Division of Real Estate (DRE).

**Determine Start-Up Costs**

You’ll need to consider a number of basic, start-up costs, such as the following:

- Legal (incorporating, licenses)
- Internet access (cable, DSL)
- Printing (stationery, business cards)
- Brochures
- Direct mail postage
- Advertising
- For sale yard signs
- Insurance (E&O, liability)
- Phone system
- Company website
- Utilities (electric, water)
- Rent
- Equipment (computer, copier, fax machine)
- Office furnishings (lease or used)
- Office supplies (paper, paperclips, pens)
- Signage
- Business software (word processing, accounting)
- Payroll
- MLS fees
- Realtor® association fees

**Prepare Your Operating Budget**

You’ll need to prepare an operating budget. To do this, determine how many associates you will need to generate the income needed to pay business expenses, and project the ongoing offices expenses, both fixed and variable.

Fixed expenses are those with a fixed (or same) amount paid each month. They include:

- Rental or mortgage payments
- Salaries
- Employer contributions for employees
- Equipment rental and maintenance contracts
- Furniture rentals
- Internet
- Insurance payments (Business risk/liability and property)
Variable expenses are those with variable amounts or intermittent payments, including:

- Advertising
- Sales commissions
- MLS listing fees
- Utilities (telephone, electric)
- Office supplies
- Printing

**Compose a Policy and Procedures Manual**

The purpose of a *Policy and Procedures Manual* is to make sure that all members of your brokerage company understand your philosophy and their roles and responsibilities as employees in the business. Use great care to express the exact purpose of your brokerage company to avoid misinterpretation. This manual provides a sense of direction for the company and includes your firm’s mission statement.

Some of the items that should be covered in the manual include:

- A statement of the company’s mission
- A statement of the company’s objectives
- An organizational chart
- A clear, accurate presentation of the company’s position on agency representation and who the company will and will not represent in a transaction
- A clear understanding of what type of properties the company will list or sell (residential, mobile homes, vacant land, and commercial)
- A clear policy of whether or not the company will be involved in property management
- A statement regarding the responsibilities and requirements of affiliated licensees
- Job descriptions for all employees, independent contractors, management, and office staff
- Office procedures, including listing, rental, and closing procedures
- Employment procedures, including compensation plan, employment agreement, and complaint and dismissal procedures
- Buyer representation procedure, if any

**Note:** It is important for this manual to have all the answers to every brokerage procedure question.

**Establish Your Brand**

Stand out, establish your brand, and let brokers know what makes you different and why they should work for you, not the competition. Attracting the right real estate professionals to your office will be a key part of your success.

Establish your brand with the public. You can accomplish this through an aggressive institutional marketing campaign.

**RECRUITING**

One could say that recruiting is the lifeblood of a growing real estate brokerage. For a real estate office to grow and prosper, it requires professional, producing associates.

The competition for new and experienced associates has always been intense and
shows no signs of letting up. The simple fact is that agents come and go for a variety of reasons. This creates an ongoing challenge for the broker both to keep the associates already employed and to expand the roster by adding new ones.

Successful recruiting is not a hit-and-miss part time proposition. Successful recruiting requires a dedicated, focused plan added to some sheer determination.

Note: Before you start your recruiting, you will need to decide whether you want your affiliated licensees to be employees or independent contractors, or some combination of each. In most firms these days, the associates are independent contractors.

- **New licensees.** An excellent place to start is by recruiting brand new licensees right out of real estate school. New licensees are considerably easier to recruit; they have positive attitudes, are eager to learn, and tend to listen. The down side is that new licensees have a substantial learning curve. Inevitably, new associates will require a lot of time, personal attention, training, and support for a while and they won’t be very productive. However, you can shorten this period with an aggressive, structured training program.

  A popular method of targeting new licensees is through the application process. When anyone makes application to the state for a real estate license, it becomes public record. It is possible to access this information through www.MyFloridaLicense.com and reach out to those applicants before they even acquire their license.

- **Experienced licensees.** Targeting the experienced, producing agent is not as easy as the new agent. Experienced agents are established in their business and can be resistant to change, unless that change is to their benefit. The odds are good that you already know who the producing agents are in your area. If not, they are easy to find by searching MLS statistics for your market area to find top-producing agents.

  In order to attract producing agents, you will need a strong value-added proposition. You’ll need to explain why they should leave their present company and transfer to you. You’ll need a good answer to the question of what you will offer to support and grow their business. In many cases, it will have to entail more than just a higher commission split.

  The agents in your office can be extremely useful in any recruiting effort, so partner with them. Your agents are in the field every day and have worked with agents from other offices. They may know experienced agents that they feel would make a great addition to the office.

  Think about offering a recruiting bonus to your present agents for every agent who joins the offices that they recommended. The amount of the bonus should be based on the production level of the recruited agent; the higher the production, the bigger the bonus.

**TRAINING**

For the broker, training is an important aspect of increasing associate production, recruiting, and maintaining associate loyalty. The problem for the broker is that it can be expensive and very time consuming. Another decision you must make is whether you will charge the associates for training.
There are various levels or types of training to offer.

- Hands-on interactive training with a professional trainer and structured curriculum
- Electronic training (videos and online programs)
- Mentoring program (on-the-job training)

The simple fact is that when the marketplace slows down, training is one of the first things brokers cut to reduce expenses. The trend in the industry has been away from training for most brokers. This is due to several reasons; cost is only one. Many brokers know that if they invest time and money in training an associate, that associate may leave to work for a broker offering a higher commission split. If the broker decides to reduce costs by not paying a professional trainer and conducting the training himself or herself, it is a huge draw on the broker’s time that causes other areas to suffer. More and more brokers are looking to their local Realtor® associations and real estate schools to fill the void.

To ensure success in this industry, all new associates need some basic fundamental skills. Without these skills, their potential for success is severely limited. Necessary training for the new associate consists of:

- Writing and understanding contracts
- Prospecting and farming for new business
- Building and presenting an effective listing presentation
- Advertising, marketing, and selling a listing
- Working with buyers

**Writing and Understanding Contracts**

A new associate must understand contracts, what they say, and the meaning of each section. This includes a detailed look at how to fill out every blank of the contract with the proper information and format, along with required disclosures.

Topics that should be included in contracts training are:

- Responsibility of preparation
- The forms program
- Considerations for completing preprinted contracts
- How to fill out the contract
- Things to look for in the contract
- Time lines in the contract
- Required addendums
- Tips for successful contract negotiation
- Proper handling of the escrow deposit when writing the contract
- Escrow deposit FREC Rule F.A.C. 61J2.4008(2)(b)

**Prospecting and Farming for Listings**

Associates need to learn different methods of prospecting for sellers. This training should include building various prospecting data bases, selecting and building a farm area, direct mail, writing advertising copy, the use of color in marketing and prospecting, and the use of social media and its various aspects in prospecting.
Training topics should include:

- It’s your business
- Technology
- Ways to develop a positive attitude
- The three keys to prospecting success
- Sphere of influence including social media
- Expired listings
- FSBOs
- Farm area
- Past clients
- Working with sellers
- Prospecting for sellers
- Five sources of listing prospects
- Prospecting concepts to consider
- Push marketing
- Pull marketing
- Prospecting tips and facts
- Social media to consider
- Real estate blogging
- Marketing the property on the internet
- Seller and buyer facts to consider
- Basic prospecting tips
- Color in prospecting and marketing
- Things to start doing today
- To-do list everyday
- To-do list weekly
- To-do list monthly

Building and Presenting an Effective Listing Presentation

Associates need to become expert in every aspect of the listing presentation. This includes building the presentation, section by section. Associates should know what a presentation includes and learn unique ideas to personalize it. They need to understand the actual listing presentation as it takes place from the time they arrive at the home until they leave.

Topics for this type of training should include:

- Your REALTOR® Association and the MLS
- Building the listing presentation, including:
  - The cover letter
  - Professional resume
  - Professional affiliations
  - Company profile
  - Marketing plan
  - Tips for preparing a home for sale
  - Tips for staging the home for showing
  - The CMA
- Things to bring to the listing presentation
- Four personality types
- Know your seller and buyer by generation
- Conducting the listing presentation
- Dressing appropriately
- Things to tell the seller at the time of listing
- Things to ask the seller for at the time of listing
- Handling seller objections
- Communication skills
- Exclusive Right of Sale Listing Agreement
- The Forms Program
- The listing file
Chapter 13

Advertising, Marketing, and Selling a Listing

Associates need to learn the details of working with sellers and servicing the listing, with substantial emphasis on marketing concepts, communicating with the seller, required technology, and marketing to real estate professionals.

Topics for this training should include:

- Working with sellers
- Technology
- Servicing the listing
- Communication
- Lockboxes
- Signs
- Effective marketing
- Marketing to other real estate professionals
- Marketing to buyers
- Writing good advertising and MLS copy
- Basic rules for advertising copy
- Using color in marketing
- Marketing concepts
- Marketing tips and facts
- Marketing the property on the Internet
- Internet facts to consider in Florida

Working with Buyers

Associates need detailed information on all aspects of working with buyers.

Topics for this training should include:

- Working with buyers
- Sources of buyer prospects
- Qualifying the buyer
- Interviewing the buyer
- Protecting your interest with buyers
- Showing agreements
- Financing
- Showing property
- The pending file
- Property inspections
- Title work

Ongoing Training

The education never stops for the true professional. Even if you are in the real estate business for fifty years, the need to continue your real estate education is critical to long term success. The constant quest to improve your presentation, prospecting, communication, and marketing skills and the need to stay abreast of changes in technology and the license law will allow you to grow your business and achieve your business goals over the long term.

In the beginning, it is critical to learn as much as you can about the industry. There is a direct correlation between training and the success of your business, but it is only the beginning. Take advantage of workshops, courses, and seminars as often as possible for you and your associates. Education and training are the keys to success in the real estate industry.
BECOMING AN OFFICE MANAGER

Have you ever thought about moving into the management end of the business? Now that you have established yourself in sales, perhaps you are ready for a new challenge. Many successful agents consider management as a way of expanding their career and accepting new challenges and responsibility.

Brokers are constantly under pressure as demands are placed on their time from all directions. Associates, clients, other brokers, association duties and so on, all require their attention. The solution is usually to hire an office manager or someone who is often referred to as a manager broker.

The office manager handles the day-to-day operations of the office and takes on a leadership role in the brokerage. In most cases, the office manager can also sell. They receive a base salary and a generous commission split on all of their sales and may receive a bonus for recruitment of new associates to the office.

One big mistake brokers and agents make when hiring an office manager is assuming that because someone was a top selling agent they will make a good office manager; this simply isn’t true. Being a top selling agent is not an indicator of leadership skills. Sure, a good office manager has to know the technical side of the business, but they must embrace substantial leadership and management skills as well. A good office manager must possess substantial industry knowledge and an acute understanding of the business, as well as be a true team player. Nothing less will suffice.

True leaders appear to exhibit several common traits. However, just having the traits is not enough. A good leader must be able to utilize these traits in the day-to-day management tasks.

The leadership traits required for a good office manager include:

- **Honesty and integrity.** Honesty and integrity are the first and maybe the most important leadership traits of a good office manager. With a multitude of scandals in the business and political communities today, associates are likely to be skeptical of an office manager especially in the beginning. If you want people to believe in you and follow you, they have to know you are honest and fair and see that you practice what you say and treat everyone equally.

- **Dedication.** Dedication to doing what it takes to get the job done is critical. Associates must know the manager is willing to put in the time necessary to accomplish the goals of the office. Selling real estate is not a 9 to 5 job; neither is management.

- **Availability.** Successful office managers are available to the associates. The associates in the office must know that when a question arises or they are in need of guidance, the manager will be there.

- **Vision.** The office manager must be able to see and embrace the vision of the broker. Not only does the office manager have to see and understand the future goals of the office, but also they must be able to convey those goals to the office associates in an effective way.

- **Creativity.** A good manager must be creative and able to think outside of the box. Being able to see different solutions to seemingly difficult problems is a strong management trait.
• **Sense of humor.** A good sense of humor can go a long way in creating a productive work environment in the office. Real estate can be a stressful business and associates are often under pressure. Humor can relieve the tension and motivate the office.

Just as there are specific qualities and traits that you want a good office manager to have, there are those that you don’t want an office manager to have. These include the following:

- Micromanaging, needing to be in control of every detail
- Not taking responsibility or passing the buck
- Reprimanding associates publicly
- Not establishing expectations
- Procrastinating in excess
- Withholding performance feedback
- Not holding others accountable for their performance

Whether you become a manager or hire one, it’s good to remember that role will be instrumental in the success of your business.

**BUILDING YOUR FUTURE**

There are certainly no guarantees, but the challenge of opening your own office can be an exhilarating experience. It is an exciting time in the marketplace today with new and unexpected opportunities for the broker who is willing to take aggressive and effective action. Not only do we have a booming population with which to work, but also people from all over the world come to Florida to buy and sell real estate. This will still be the case when you become a broker. As the owner of your own office, you are in a desirable position to benefit directly from this dynamic, fluid real estate market. Think about it. Everyone needs to live somewhere, work somewhere, and shop somewhere. The potential for your success is truly unlimited.

“A sense of humor is part of the art of leadership, of getting along with people, of getting things done.”

- Dwight D. Eisenhower

"Action is the foundational key to all SUCCESS.
~ Pablo Picasso"
CHAPTER 13 REVIEW QUESTIONS

1. With a ____________________________, partners are ________ and ________ liable for all debts and liabilities of the business. At least _______ partner must be licensed as an active broker. ____________________________ and ____________________________ may not be partners.

2. A ____________ can offer considerable advantages for the new broker, such as name recognition, proven business model, startup and ongoing support, training, and advertising.

3. The biggest advantage to a new broker who decides to open an independent firm rather than a franchise is the ____________________________.

4. In the ____________________________ business model, the broker provides substantial support services for the associates who are typically hired at an entry-level commission split of _____% to _____%.

5. The ____________________________ business model gained popularity as brokers were forced to scale back the support for their associates in order to increase the commission splits. With this model, brand new associates with little or no experience are brought in at a _____% to _____% commission level.

6. A ____________________________ is like a traditional office except it operates exclusively online.

7. For most brokers starting a new business, the single biggest expense is ____________________________.

8. When preparing your budget, you’ll need to project the ongoing offices expenses, both ________ and ____________________________.

9. The purpose of a ____________________________ is to make sure all members of your brokerage company understand your philosophy and their roles and responsibilities as employees.

10. In most brokerage firms today, most of the associates are hired as ____________________________.

11. The various types of training a broker can offer a new associates includes ____________________________, ____________________________, and ____________________________.

12. Often when the marketplace slows down, ____________________________ is the first thing brokers cut to reduce expenses.

13. One area of necessary training for a new associate is writing and understanding ____________________________.

14. The ____________________________ handles the day-to-day operations of the office and takes on a leadership role in the brokerage.

15. The important leadership traits of a good office manager are ____________________________ and ____________________________, ____________________________, ____________________________, ____________________________, ____________________________, and a ____________________________.
CHAPTER 13 PRACTICE EXAM

1. Which skill is the LEAST important in the selection of a good brokerage office manager?
   a. Acute understanding of the technical aspects and procedures of the business
   b. Substantial real estate industry knowledge
   c. Strong management and leadership skills
   d. Long history as a top-selling broker

2. Which type of business organization has a parent-subsidiary structure with an ongoing outlay of money to the parent organization based on a percentage of sale fees?
   a. Franchise
   b. Sole Proprietor
   c. Corporation
   d. Partnership

3. What type of brokerage specialty deals with selling homes, condominiums, cooperatives, and other properties designed to be used as living space?
   a. Industrial
   b. Residential brokerage
   c. Commercial brokerage
   d. Property management

4. Broker Fred has a home office and has no licensed associates. Under which business model is Fred working?
   a. Reduced service/higher commission
   b. Traditional/full-service
   c. High or 100% commission
   d. Broker sells/no associates

5. What is the first rule of an effective business plan?
   a. Put it in writing.
   b. Start with the little details you already know you want.
   c. Let your market define itself.
   d. Build your budget after you’ve been in business long enough to understand your expenses.

6. What is the main purpose of a business brokerage?
   a. To specialize in selling industrial properties
   b. To specialize in selling or leasing income-producing properties
   c. To specialize in helping small business owners in the buying and selling process
   d. To manage residential, commercial, or industrial properties

7. A broker decides to be a selling broker instead of focusing strictly on managing the business. Which of the following is LEAST likely to occur?
   a. It is difficult to recruit new associates.
   b. A full time office manager is required.
   c. Associates are motivated by the broker’s successful sales.
   d. Associates consider themselves in competition with the broker.

8. When preparing an operating budget, which expense is considered a variable expense?
   a. MLS listing fees
   b. Salaries
   c. Rent or mortgage payments
   d. Insurance payments

9. Which item should NOT be included in a Policy and Procedures Manual?
   a. Mission statement
   b. Budget statement
   c. List of responsibilities for licensees
   d. Office, listing, rental, and closing procedures

10. What approach will MOST likely result in successful recruitment of experienced, top-performing licensees?
    a. Check the public records for new applicants for a real estate license.
    b. Explain how the licensee will benefit and grow more in your business than their current business.
    c. Offer additional training opportunities.
    d. Offer to match the current employer’s commission split.
11. What type of broker specialty deals with selling or leasing income-producing properties such as malls, office parks, restaurants, gas stations, convenience stores, and office towers?
   a. Property management
   b. Industrial brokerage
   c. Commercial brokerage
   d. Residential brokerage

12. In what type of business model would an associate expect to receive a 95 to 100% commission plan?
   a. Base rate commission
   b. Traditional/full service
   c. Split/progressive
   d. High commission

13. What type of training should the broker provide to instruct associates on the procedures for lockboxes, signage, and effective marketing?
   a. Writing and understanding contracts
   b. Prospecting and farming for listings
   c. Advertising, marketing, and selling a listing
   d. Working with buyers

14. Which of the following is NOT a positive trait of an office manager?
   a. Accountability
   b. Establishing expectations
   c. Taking responsibility
   d. Micromanaging

15. What type of business is formed by one independent registered broker who employs sales associates to perform real estate transactions?
   a. Real estate brokerage partnership
   b. Sole proprietorship brokerage
   c. Real estate brokerage corporation
   d. Franchised brokerage business
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ANSWER KEY

Chapter 1 Review
1. farming
2. (1) four, condominium units, (2) four, (3) ten, (4) four, (5) four
3. Industrial sales
4. Business brokerage
5. Counseling
6. National Association of REALTORS® (NAR), REALTORS®
7. Florida Association of REALTORS® (FAR), Florida REALTORS®
8. NAR, FAR, MLS
9. Florida Association of REALTORS® (NAR), REALTORS® (FAR), Florida REALTORS®
10. clients, customers, public, other real estate licensees
11. designations, certifications
12. valuation, marketing, property transfer
13. market statistics, available inventory, distressed properties
14. Multiple Listing Service (MLS)
15. income, operating expenses

Chapter 1 Practice Exam
1. b
2. c
3. b
4. b
5. c
6. b
7. a
8. d
9. c
10. d
11. d
12. c
13. d
14. c
15. b

Chapter 2 Review
1. 455
2. 475
3. 61J2
4. FIRPTA, foreign investor
5. NAR Code of Ethics
6. 475
7. reprimand, fine, probation, suspension, revocation or denial
8. post-license, 45
9. 14
10. ten days
11. convicted, found guilty, entered a plea of nolo contendere, guilty
12. fraudulent, false, deceptive, misleading
13. end of the business day
14. one registered employer
15. single agency, no brokerage

Chapter 2 Practice Exam
1. a
2. d
3. b
4. c
5. a
6. c
7. b
8. c
9. a
10. c
11. b
12. b
13. d
14. c
15. c

Chapter 3 Review
1. Uniform Standards of Professional Appraisal Practice (USPAP), appraisers, 475
2. Market value
3. Investment value
4. Liquidation value, failing business
5. anticipation, income-producing or investment
6. contribution, increases, decreases
7. substitution
8. highest and best use
9. cost-depreciation
10. comparable sales, substitution
11. subject property, comparables
12. neighborhood, home site, property features
13. comparable, subject property
14. add, subtract
15. broker price opinion (BPO), real estate owned (REO)

Chapter 3 Practice Exam
1. c
2. b
3. b
4. d
5. c
6. a
7. c
8. c
9. b
10. d
11. a
12. b
13. d
14. d
15. a

Chapter 4 Review
1. number, consistency, system
2. database, contact management software
3. geographic farm area

Chapter 4 Practice Exam
1. Push, Pull
2. Tombstone, Direct response
3. property, name, address, contact
4. experience, education, professional affiliations
5. motivation, expectations
6. listing contract, automatic renewal
7. open, unilateral
8. exclusive
9. exclusive right of sale
10. net
11. communication
12. AIDA, attention, interest, desire, action

Chapter 5 Review
1. primary mortgage market
2. origination
3. secondary mortgage market, Ginnie Mae, Fannie Mae, Freddie Mac
4. origination, Discount, 1
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13. total obligations ratio 41
14. underwriting
15. gift letter

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4. b
5. d
6. d
7. a
8. b
9. d
10. c
11. c
12. a
13. c
14. d
15. b

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3. property disclosure statement
4. murder, suicide
5. Statute of Frauds
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10. initial
11. Force Majeure
12. “As Is”, disclose material defects
13. option, optionee, optionor, unilateral, valuable consideration
14. abandonment
15. five, two

Chapter 6 Practice Exam
1. c
2. a
3. b
4. d
5. c
6. a
7. b
8. a
9. c
10. b
11. d
12. c
13. a
14. b
15. c

Chapter 7 Review
1. interior, T, flag, flag, key
2. substructure
3. crawl space, slab, concrete, steel
4. Slab-on-grade, footers
5. superstructure
7. R-value, higher
8. Loose-fill, Reflective, rigid, Foam
9. PVC
10. temperature and pressure relief valve
11. BTU’s
12. refrigerant, evaporator, condenser, drain line
13. heat pump, reversing valve, heat strip

Chapter 7 Practice Exam
1. a
2. c
3. c
4. d
5. c
6. b
7. d
8. c
9. b
10. a
11. b
12. d
13. a
14. c
15. a
14. ground fault interrupters (GfIs)
15. building codes

Chapter 7 Practice Exam
1. a
2. c
3. a
4. c
5. b
6. b
7. a
8. a
9. d
10. c
11. c
12. b
13. a
14. b
15. d

Chapter 8 Review
1. race, color, religion, sex, national origin, handicap, familial status
2. race
3. reasonable, tenant’s
4. steering, limiting choices
5. blockbusting, panic selling (or panic peddling)
6. redlining
7. fair housing (or hud) poster, broker
8. racial, (1) real estate professional, (2) advertising
9. americans with disabilities act (ada), open to the public
10. readily available, multifamily
11. conciliation
12. $16,000
13. 760, 475
14. perceived
15. your employing broker

Chapter 8 Practice Exam
1. a
2. d
3. c
4. d
5. a
6. d
7. d
8. b
9. b
10. b
11. a
12. c
13. b
14. c
15. d

Chapter 9 Practice Exam
1. c
2. d
3. a
4. d
5. a
6. d
7. d
8. b
9. b
10. b
11. a
12. c
13. b
14. c
15. d

Chapter 10 Review
1. forbearance, moratorium
2. restructuring
3. subject to, nonrecourse
4. deed in lieu of foreclosure, warranty, quitclaim
5. voluntary conveyance, foreclosure
6. deficiency balance, legal counsel, bankruptcy
7. short sale
8. (1) for sale, (2) multiple payments, credit rating, (3) financial hardship
9. financial hardship, changed financial circumstances
10. foreclosure, notice of default, catch up on payments
11. lis pendens, notice of sale, certificate of sale
12. courthouse
13. government
14. private
15. open outcry

Chapter 10 Practice Exam
1. a
2. c
3. d
4. b
5. b
6. c
7. a
8. a
9. b
10. d
11. c
12. a
13. c
14. c
15. b

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1. (1) 718; (2) 719; (3) 721; (4) 720
2. condominium, common elements
3. articles of incorporation, bylaws
4. offering plan
5. letter of intent, purchase agreement
6. form of ownership, condominium, cooperative (or co-op), shares of stock
7. operating expenses
8. (1) real estate tax, (2) interest payment, (3) interest payment, foreclosure
9. statement of financial position
10. board meeting minutes
11. subscription agreement
12. interval ownership, right to use
13. (1) 10-day, (2) leisure-time activity, investment
14. compensation, ten, $100,000
15. (1) funds, (2) budgets, financial, (3) notice of meetings, (4) maintenance

Chapter 11 Practice Exam
1. (1) funds, (2) budgets, financial, (3) notice of meetings, (4) maintenance
2. compensation, ten, $100,000
3. (1) 10-day, (2) leisure-time activity, investment
4. (1) real estate tax, (2) interest payment, (3) interest payment, foreclosure
5. statement of financial position
6. board meeting minutes
7. subscription agreement
8. interval ownership, right to use
9. (1) funds, (2) budgets, financial, (3) notice of meetings, (4) maintenance

Chapter 12 Review
1. risk, liquidity, leverage, risk, rate of return
2. liquid, illiquid, liquid, illiquid
3. leverage, loan-to-value (LTV)
4. (1) office buildings, (2) residential, keep, flip, (3) commercial, (4) industrial
5. due diligence, environmental, government, community
6. expenses, gross income
7. fixed, variable, reserve for replacements
8. cash flow, positive cash flow
9. before-tax cash flow (BRCF), after-tax cash flow (ATCF)
10. marginal tax bracket
11. taxable income, less
12. basis, cost basis, adjusted basis, beginning (or initial) basis
13. adjusted basis, realized, unrealized, capital losses
14. depreciation, straight-line basis, 27.5, 39
15. section 1031, defer

Chapter 12 Practice Exam
1. c
2. a
3. a
4. c
5. d
6. b
7. b
8. c
9. b
10. d
11. b
12. d
13. a
14. d
15. c

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7. office space
8. fixed, variable
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10. independent contractors
11. hands-on, electronic, on-the-job (mentoring)
12. training
13. contracts
14. office manager
15. honesty, integrity, dedication, availability, vision, creativity, sense of humor

Chapter 13 Practice Exam
1. d
2. a
3. b
4. d
5. a
6. c
7. c
8. a
9. b
10. b
11. c
12. d
13. c
14. d
15. b

Chapter 14 Practice Exam
1. risk, liquidity, leverage, risk, rate of return
2. liquid, illiquid, liquid, illiquid
3. leverage, loan-to-value (LTV)
4. (1) office buildings, (2) residential, keep, flip, (3) commercial, (4) industrial
5. due diligence, environmental, government, community
6. expenses, gross income
7. fixed, variable, reserve for replacements
8. cash flow, positive cash flow
9. before-tax cash flow (BRCF), after-tax cash flow (ATCF)
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